





ENTERED

AUG 18 1966

Mary B. Still

F 2302

# San Francisco Law Library

436 CITY HALL

No. 183 702


## EXTRACT FROM RULES

Rule 1a. Books and other legal material may be borrowed from the San Francisco Law Library for use within the City and County of San Francisco, for the periods of time and on the conditions hereinafter provided, by the judges of all courts situated within the City and County, by Municipal, State and Federal officers, and any member of the State Bar in good standing and practicing law in the City and County of San Francisco. Each book or other item so borrowed shall be returned within five days or such shorter period as the Librarian shall require for books of special character, including books constantly in use, or of unusual value. The Librarian may, in his discretion, grant such renewals and extensions of time for the return of books as he may deem proper under the particular circumstances and to the best interests of the Library and its patrons. Books shall not be borrowed or withdrawn from the Library by the general public or by law students except in unusual cases of extenuating circumstances and within the discretion of the Librarian.

Rule 2a. No book or other item shall be removed or withdrawn from the Library by anyone for any purpose without first giving written receipt in such form as shall be prescribed and furnished for the purpose, failure of which shall be ground for suspension or denial of the privilege of the Library.

Rule 5a. No book or other material in the Library shall have the leaves folded down, or be marked, dog-eared, or otherwise soiled, defaced or injured, and any person violating this provision shall be liable for a sum not exceeding treble the cost of replacement of the book or other material so treated and may be denied the further privilege of the Library.



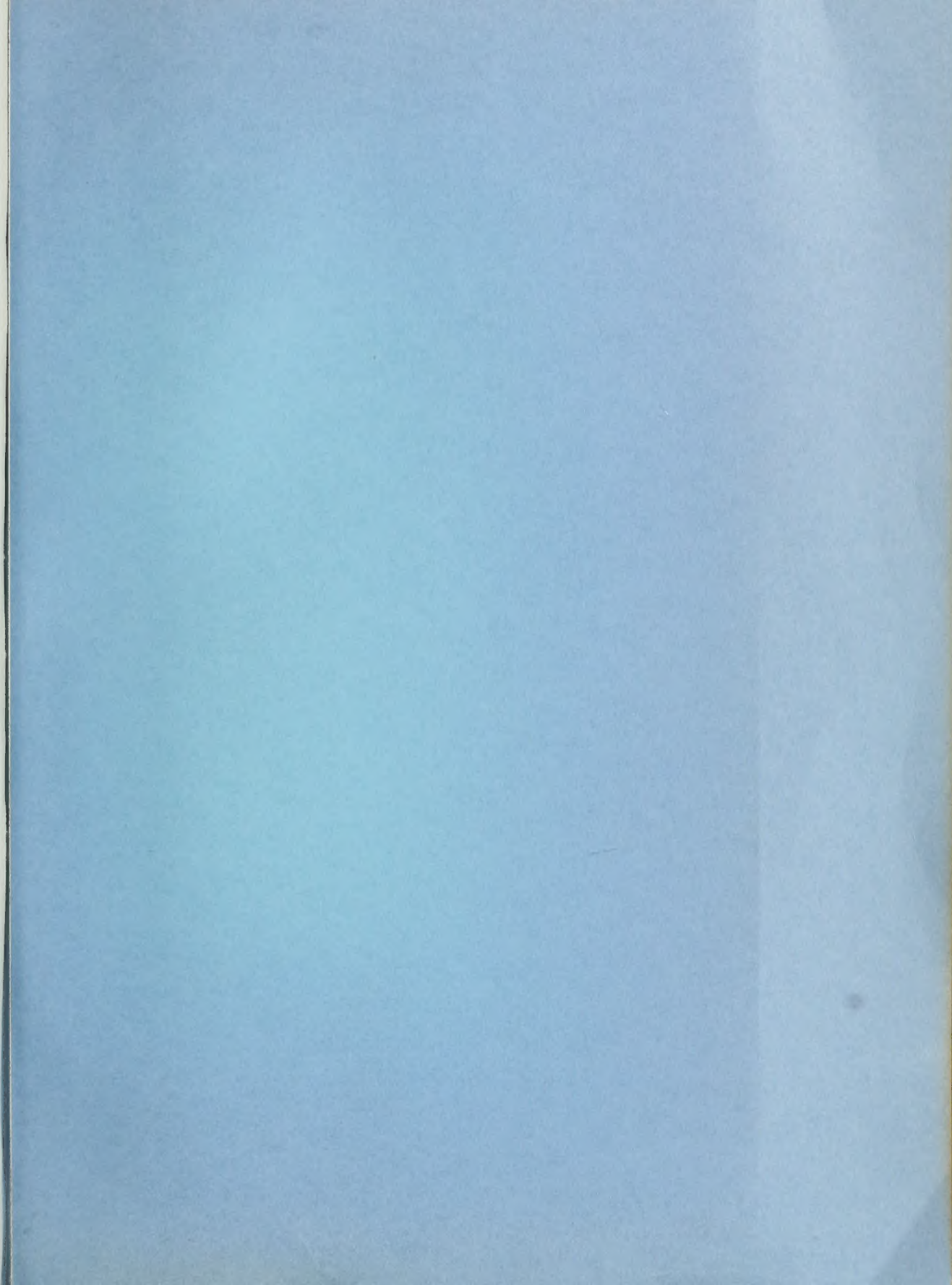


Digitized by the Internet Archive  
in 2010 with funding from  
Public.Resource.Org and Law.Gov

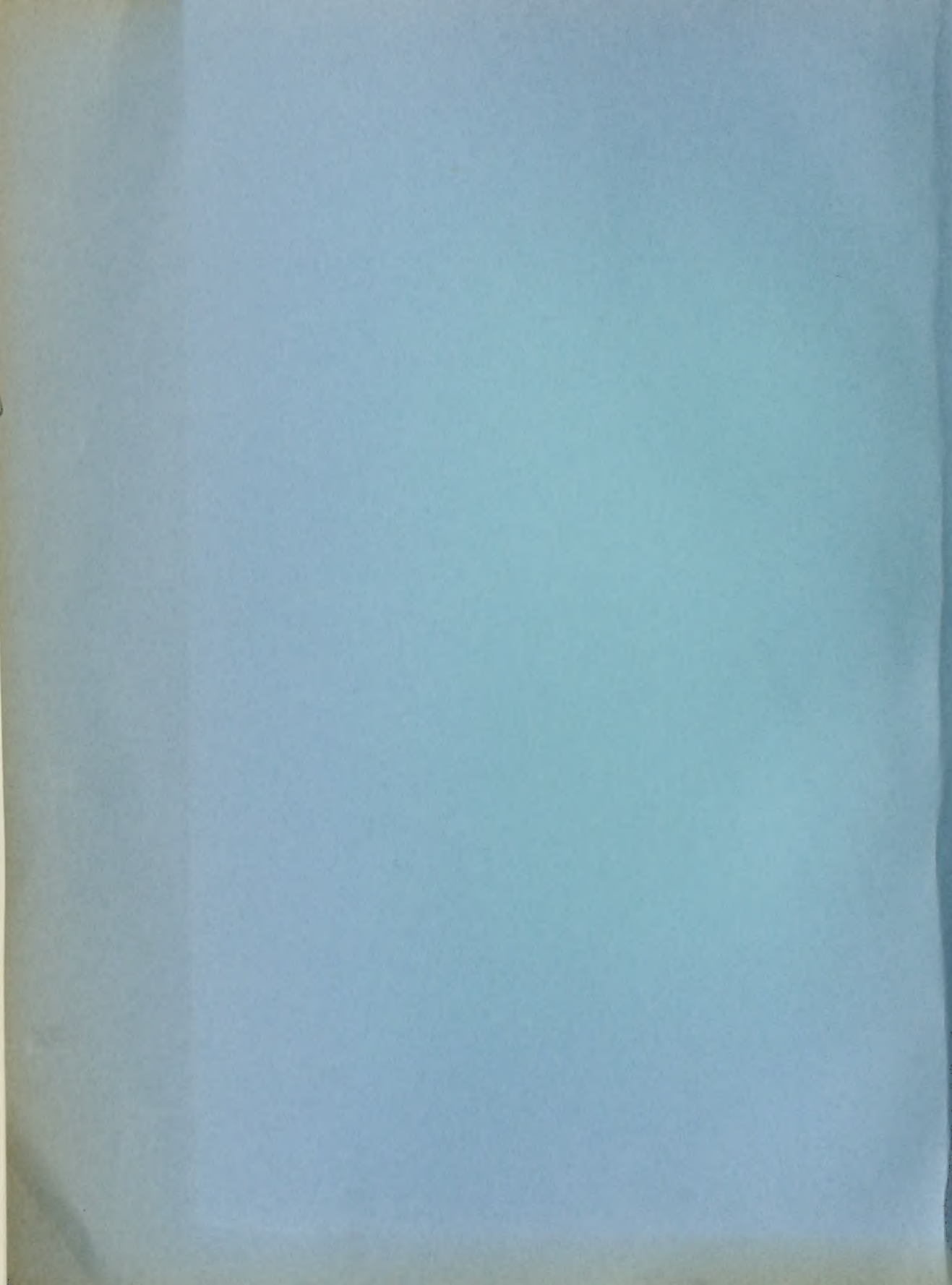














**In the United States Court of Appeals  
for the Ninth Circuit**

---

**JORGE HEDDERICH, JR., APPELLANT**

*v.*

**EDGAR W. RICHARDS, AND UNITED STATES  
OF AMERICA, APPELLEES**

---

**On Appeal from the Judgment of the United States  
District Court for the Southern District of California**

---

**BRIEF FOR THE UNITED STATES**

---

**RICHARD M. ROBERTS,**  
*Acting Assistant Attorney General.*

**LEE A. JACKSON,  
JOSEPH KOVNER,  
ANTHONY ZELL ROISMAN,**  
*Attorneys,  
Department of Justice,  
Washington, D.C. 20530.*

*Of Counsel:*

**MANUEL L. REAL,**  
*United States Attorney.*

**LOYAL E. KEIR,**  
*Assistant United States Attorney.*

**FILED**

**JAN 27 1966**

**WM. B. LUCK, CLERK**

---





## INDEX

	Page
Opinion below .....	1
Jurisdiction .....	1
Questions presented .....	2
Statutes involved .....	3
Statement .....	3
Summary of argument .....	7
<b>Argument:</b>	
I. The District Court was correct in holding that prior recordation of the United States tax liens gave the United States priority to an obligation due the taxpayer over an assignee of the obligation or a subsequent holder of the obligation who did not pay adequate consideration for it .....	8
II. Alternatively, the service of a tax levy on a debtor of the taxpayer entitled the United States to recover under Section 6332(b) of the Internal Revenue Code of 1954 the amount of the debt when it came due from the debtor ..	15
Conclusion .....	18
Appendix .....	19

## CITATIONS

### Cases:

<i>Bogan v. Wiley</i> , 90 Cal. App. 2d 288, 202 P. 2d 824 .....	9
<i>Bramante v. Krug</i> , 143 Cal. App. 2d 771, 300 P. 2d 71 .....	11, 14
<i>Citizen State Bank of Barstow, Tex. v. Vidal</i> , 114 F. 2d 380 .....	10
<i>Commissioner v. Duberstein</i> , 363 U. S. 278 .....	16
<i>Division of Labor Law Enforcement v. United States</i> , 301 F. 2d 82 .....	15

## Cases—Continued

	Page
<i>Hoye v. United States</i> , 277 F. 2d 116 .....	16
<i>Investment &amp; Securities Co. v. United States</i> , 140 F. 2d 894 .....	10
<i>Kirby v. United States</i> , 329 F. 2d 735 .....	15
<i>Nelson v. United States</i> , 139 F. 2d 162, certiorari denied, 322 U.S. 764 .....	10
<i>Pool v. Walsh</i> , 282 Fed. 620 .....	16
<i>Rogers v. Harris</i> , 138 Cal. App 2d 1, 291 P. 2d 68 .....	9, 16
<i>Sims v. United States</i> , 359 U. S. 108 .....	16
<i>Stuart v. Chinese Chamber of Commerce of Phoenix</i> , 168 F. 2d 709 .....	16
<i>United States v. Eiland</i> , 223 F. 2d 118 .....	15
<i>United States v. Gypsum Co.</i> , 333 U. S. 364 .....	16
<i>United States v. Phillips</i> , 198 F. 2d 634 .....	10
<i>Walker v. Paramount Engineering Co.</i> , decided December 2, 1965 (66-1 U.S.T.C., par. 9106) ..	10
<i>Worley v. United States</i> , 340 F. 2d 500 .....	9, 10

## Statutes:

## Internal Revenue Code of 1954:

Sec. 6321 (26 U.S.C., 1958 ed., Sec. 6321) ....	19
Sec. 6323 (26 U.S.C., 1958 ed., Sec. 6323) ....	19
Sec. 6331 (26 U.S.C., 1958 ed., Sec. 6331) ....	20
Sec. 6332 (26 U.S.C., 1958 ed., Sec. 6332) ....	21

## Civil Code, 11 West's Annotated California Codes:

Sec. 3097 .....	22
Sec. 3111 .....	22
Sec. 3133 .....	22
Sec. 3136 .....	23
Sec. 3140 .....	23

## Miscellaneous:

Federal Rules of Civil Procedure, Rule 52 .....	12
---	----



**In the United States Court of Appeals  
for the Ninth Circuit**

---

No. 20,123

**JORGE HEDDERICH, JR., APPELLANT**

*v.*

**EDGAR W. RICHARDS, AND UNITED STATES  
OF AMERICA, APPELLEES**

---

**On Appeal from the Judgment of the United States  
District Court for the Southern District of California**

---

**BRIEF FOR THE UNITED STATES**

---

**OPINION BELOW**

The memorandum and order and findings of facts and conclusions of law of the District Court (I-R. 15-28)<sup>1</sup> are not officially reported.

**JURISDICTION**

This action was brought on a complaint (I-R. 2-6) filed November 22, 1961, in the United States District Court for the Southern District of California to collect on a promissory note. The United States was

---

<sup>1</sup> I-R. references are to the reproduced transcript of the record.

named a party defendant pursuant to 28 U.S.C., Section 2410(a). Assessments for unpaid taxes had been made against Henry Albachten, payee of the promissory note, on July 23, 1957, in the sums of \$62,701.98 for 1952, \$114,543.53 for 1953 and \$33,331.96 for 1954 and notices of the liens were filed in Ashland, Oregon, Albachten's residence, on July 26, 1957. (I-R. 23-24.) A notice of levy with respect to the tax liability was served on Edgar W. Richards, maker of the promissory note, on September 13, 1957. (I-R. 25.) Jurisdiction was conferred on the District Court by 28 U. S. C., Section 1332(a). The judgment of the District Court was originally entered on May 20, 1964 (I-R. 58-59), but later vacated and re-entered on March 9, 1965 (I-R. 29-30), in order to permit the plaintiff to perfect this appeal (I-R. 67). On March 25, 1965, a notice of appeal was filed. (I-R. 32-33.) Jurisdiction is conferred on this Court by 28 U. S. C., Section 1291.

### QUESTIONS PRESENTED

1. Whether the District Court was correct in holding that prior recordation of the United States tax liens gave the United States priority to an obligation due the taxpayer over an assignee of the obligation or a subsequent holder of the obligation who did not pay adequate consideration for it.

2. Whether, alternatively, service of a tax levy on a debtor of the taxpayer entitled the United States to recover under Section 6332(b) of the Internal Revenue Code of 1954 the amount of the debt when it came due from the debtor.



## STATUTES INVOLVED

All relevant statutes are set forth in the Appendix, *infra*.

## STATEMENT

Henry Albachten, taxpayer, managed a company developing a real estate subdivision, Chula Vista, at Lake Chapala, Mexico. In January, 1957, he negotiated with La Casa Electrica Company in which appellant Jorge Hedderich, Jr., had some interest and of which he was an employee for purchase in the future of electrical equipment and its installation in the subdivision. (I-R 23.)

On or about June 6, 1957, appellee Edgar W. Richards executed the following promissory note in favor of Henry Albachten in Los Angeles, California (I-R. 23):

\$21,875

June 6, 1957

June 6, 1961 after date I promise to pay to the order of Rita or Henry Albachten at Los Angeles, California Twenty One Thousand Eight Hundred Seventy-Five and No/100 Dollars, for value received with interest at six (6) percent per annum from June 6, 1957 until paid. Interest payable at maturity of Note (simple interest) both principal and interest payable in lawful money of the United States.

(signed) ANGELES ELEC Co.  
9509 So. San Pedro - LA 3

Due June 6, 1961

(signed) E. W. RICHARDS

Albachten, the payee, did not take possession of the document but left it in Richards' possession. (I-R. 23.)

Federal tax liens in the amount and of the type shown arose on the dates noted below and notices of tax liens were filed with the County Recorder of Ashland, Oregon, where Albachten resided, on the additional dates shown below (I-R. 23-24):

<u>Type of Tax</u>	<u>Taxable Period</u>	<u>Amount Assessed</u>	<u>Assessment Date</u>	<u>Lien No.</u>	<u>Lien Filed</u>
Income	1952	\$ 62,701.98	7/23/57	54602	7/26/57
Income	1953	114,543.53	7/23/57	54602	7/26/57
Income	1954	33,331.96	7/23/57	54602	7/26/57

On or about July 30, 1957, in Gaudalajara, Mexico, taxpayer executed the following document (I-R. 24):

Agreement—George Hedderich &  
Henry E. Albachten

The undersigned hereby assigns all of his interest in that certain promissory note dated June 6, 1957 in the amount of \$21,875.00 dlls (U.S.C.). This note is between "Angeles Electric Co., E. W. Richards and the undersigned. This assignment is to secure credit being advanced by Jorge Hedderich and I promise to endorse this note to Jorge Hedderich as soon as I receive possession.

July 30, 1957  
Henry E. Albachten

Accepted  
G. Hedderich



Hedderich, as an employee of La Casa, and Albachten apparently agreed in July, 1957, that the note should be accepted in lieu of cash for some of the work to be done on the subdivision. However, no legal binding contract of purchase of electrical equipment had ever been entered into and sufficient cash was paid subsequent to July, 1957, by the taxpayer such that Hedderich testified that "Chula Vista owed very little" at the time the note was delivered. The assignment of the note and its subsequent delivery was merely security for future installments of possible purchases. (I-R. 24-25.)

On September 13, 1957, notice of levy was served on Richards by Revenue Officer Lawrence Spencer. The levy has never been released. (I-R. 25.)

Special Agents Samuel Phoebus and Paul Corbett called on Richards at his office and discussed the note with him. The agents saw the note but declined to take it because they had no authority to take it. Richards did not inform the agents that three days before he had been served with a notice of tax lien. Agent Phoebus told Richards to hold the note and not deliver it to any other party. He also informed Richards that Albachten was in serious tax trouble. Richards understood that the notice of lien meant his obligation was to the United States rather than Albachten. (I-R. 25.)

In November or December of 1957, Albachten contacted Richards and asked for the note. Richards told him that there was a levy from the Government but Albachten replied, "I know that, and I have been up to the Internal Revenue people trying to straighten

this out, but, I would like the note". Richards then delivered the note to Albachten. (I-R. 25-26.)

On or about December 17, 1957, in Guadalajara, Mexico, Albachten delivered the note to Hedderich. (I-R. 26.)

On May 2, 1961, Hedderich wrote to Richards informing him that the note had been negotiated to Hedderich several years earlier and that payment should be made to his attorney on the due date. On the due date, June 6, 1961, Richards refused to pay the United States or Hedderich stating he was willing to pay either but not both. Hedderich then instituted this suit. (I-R. 26.)

The District Court held that Hedderich was not a "mortgagee, pledgee, or purchaser" "for an adequate and full consideration in money or money's worth" under Section 6323 of the Internal Revenue Code of 1954, and was thus subordinate to the earlier assessed and filed federal tax liens. (I-R. 20, 26.) It also held that no estoppel should apply against the United States noting that all parties had contributed to the situation and none was more blameworthy than the other. (I-R. 20-21, 26-27.) Thus, the court held that Hedderich was entitled to no recovery and the United States was entitled to recovery against Richards (I-R. 26-27) in the amount of \$30,953 plus additional interest as provided by law (I-R. 30). This judgment was set aside and re-entered at a later date to allow Hedderich to perfect and file his appeal. (I-R. 67.) Notice of appeal was then timely filed by Hedderich. (I-R. 32.)

## SUMMARY OF ARGUMENT

United States tax liens were filed against Henry Albachten on July 26, 1957. At that time Edgar Richards was indebted to the taxpayer and held as a memorandum of that debt an undelivered promissory note of which he was the maker and the taxpayer the payee. On July 30, 1957, taxpayer <sup>also</sup> signed all of his interest in the note to Jorge Hedderich. The United States by its recorded tax liens took priority over the subsequent assignee of any of the property of the taxpayer. The assignment was additionally defective because it purported to assign a promissory note which had never been delivered by the maker, Richards. Under California law the note had no legal significance and thus could not be assigned. Subsequent delivery of the note by Richards to the taxpayer and its additional delivery to Hedderich did not make Hedderich a "purchaser" of a "security" under Section 6323 (c)(1) of the Internal Revenue Code of 1954 because he did not prove that at that time he paid "an adequate and full consideration" for the note and the recorded tax lien gave the United States a prior right to the note even as against such a holder of the note.

Alternatively, the United States levied upon all property of the taxpayer in the hands of Richards. At that time Richards was indebted to the taxpayer and held as a memorandum of that debt the promissory note which had not been delivered to the taxpayer. This note was not property of the taxpayer and not subject to levy by the United States. The



United States levy seized the debt due the taxpayer. Subsequent delivery of the note to the taxpayer and its further delivery to a holder did not interfere with the United States' right to recover directly from Richards on the debt when it came due.

## ARGUMENT

### I

**The District Court Was Correct In Holding That Prior Recordation of the United States Tax Liens Gave the United States Priority To An Obligation Due the Taxpayer Over An Assignee of the Obligation or a Subsequent Holder of the Obligation Who Did Not Pay Adequate Consideration for It**

This case involves the claims of Jorge Hedderich, Jr., and the United States to a debt due the taxpayer Henry Albachten by Edgar W. Richards. Hedderich's claim is based upon an assignment and subsequent delivery to him of a promissory note on which Richards is the maker and Albachten is the payee and of which Hedderich claims to be a holder in due course. The United States claim is that its tax liens, notices of which were filed before the assignment to Hedderich, gave the United States a prior right to the obligation and that subsequent delivery of the obligation to Hedderich for an inadequate consideration did not alter that priority. Alternatively, although not raised in its answer or in the pre-trial order, the United States argued in its brief below that Richards, having been served with a federal tax levy covering the debt he owed the taxpayer, the levy being filed before the note had been de-

livered by the maker, was personally liable for the amount of the debt under Section 6332 of the Internal Revenue Code of 1954, Appendix, *infra*, for his failure to honor the levy.

At this point in our argument we shall consider the federal tax priority as against Hedderich. Briefly, this priority involves the provisions of Sections 6321 and 6323 of the Internal Revenue Code of 1954, Appendix, *infra*. Under these provisions, the federal tax lien arising upon assessment, is effective upon recordation as against any purchaser of a taxpayer's property, with the exception that actual notice of the federal tax lien is required to render it effective as against any purchaser for an adequate and full consideration in money or money's worth of a security, e.g. negotiable instruments or money. Hedderich's assignment falls within the recordation provisions of Section 6323(a), since the assignment of the undelivered promissory note cannot be regarded as the assignment of a negotiable instrument or money. *Worley v. United States*, 340 F. 2d 500 (C. A. 9th). Indeed, the undelivered note was, under California law, a nullity. "incomplete and revocable". Civil Code, 11 West's Annotated California Codes, Section 3097;<sup>2</sup> see also *Rogers v. Harris*, 138 Cal. App. 2d 1, 291 P. 2d 68; *Bogan v. Wiley*, 90 Cal. App. 2d 288, 202 P. 2d 824.

The federal tax lien in this case arose on July 23, 1957, and upon filing of notices on July 26, 1957 in

---

<sup>2</sup> All references to sections of the Civil Code will be to 11 West's Annotated California Codes.

Ashland, Oregon, the residence of the taxpayer (I-R. 23-24) became effective as against any subsequent assignees of any debts due the taxpayer. *Walker v. Paramount Engineering Co.* (C. A. 6th), decided December 2, 1965 (66-1 U.S.T.C., par. 9106); *Investment & Securities Co. v. United States*, 140 F. 2d 894, 895 (C. A. 9th). The assignment by Albachten to Hedderich, on which Hedderich first relies here, was executed on July 30, 1957, after recordation of the federal tax liens. (I-R. 24.)

It is clear beyond question that an assignee of any property of a taxpayer, for value or otherwise, is defeated by a United States tax lien which is recorded prior to the assignment. *Worley v. United States*, 340 F. 2d 500 (C. A. 9th); *Nelson v. United States*, 139 F. 2d 162, 163 (C. A. 9th, certiorari denied, 322 U.S. 764); *Citizens State Bank of Barstow, Tex. v. Vidal*, 114 F. 2d 380, 384 (C. A. 10th); *United States v. Phillips*, 198 F. 2d 634, 635-636 (C. A. 5th).<sup>3</sup> Thus at the time of the assignment Hedderich's interest in whatever property the taxpayer had assigned to him was encumbered with a prior perfected tax lien and additionally, the assignment was of a promissory note which did not legally exist.<sup>4</sup>

---

<sup>3</sup> The cases cited by Hedderich (Br. 16) are obviously inapplicable here because they did not involve creditors with liens on the property which were recorded prior to the assignee.

<sup>4</sup> It is significant that at the date of the assignment Hedderich must have been aware that he had received nothing of value for he (1) still hoped to recover cash rather than the note (II-R. 34 (II-R. references are to the transcript of proceedings); Ex. R-A, p. 38 (all references to Ex. R-A are to



Hedderich's alternative claim is that if he gained no superior rights by the assignment of the taxpayer's interest in the note, he nevertheless became a purchaser of the note without actual notice of the federal tax lien when the taxpayer later delivered the note to him on or about December 17, 1957. But, as previously stated, Section 6323(c)(1), 1954 Code only affords the protection of actual notice of a federal tax lien to those who pay "adequate and full consideration in money or money's worth" for a negotiable instrument. The District Court here has found as a fact that Hedderich did not pay adequate and full consideration, but very little, if any (I-R. 25, Finding of Fact 6), and has concluded, therefore, that Hedderich has failed to prove that he is within the protection of Section 6323(c)(1) 1954 Code (I-R. 26, Conclusion 2).<sup>5</sup>

The legal conclusion is beyond dispute, and the question on this branch of the case is therefore solely one of fact, whether the trial court's finding of fact

---

the deposition of Jorge Hedderich, February 15, 1963)) and (2) was fully aware that a note is transferable only by delivery (Ex. R-A, pp. 23-24).

<sup>5</sup> Even under California law, to be a holder in due course one must, *inter alia*, take the instrument "for value". Civil Code, Section 3133(3), Appendix, *infra*. The burden of proving adequate consideration is on the party claiming it where, as here, he has received a negotiable instrument from one whose title to the instrument was defective. Civil Code, Sections 3136, 3140, Appendix, *infra*. Albachten negotiated the note to Hedderich with full knowledge by Albachten of the prior tax liens and levy (I-R. 25-26; II-R. 71-72) and thus his title to the note was defective. Civil Code, Section 3136. *Bramante v. Krug*, 143 Cal. App 2d 771, 300 P. 2d 71.

is supported by evidence and not clearly erroneous. Federal Rules of Civil Procedure, Rule 52. An examination of the record demonstrates that there is ample evidence to support the finding. Indeed, in an attempt to meet his burden of proving full consideration Hedderich has offered almost no evidence. Specific proof such as books or records, which do exist (II-R. 16; Ex. R-A, pp. 19-20), or even precise dollars and cents figures (see for example II-R. 47-49) were never presented. All that was offered was the self-serving testimony of Hedderich himself of a "hazy business transaction" (I-R. 20). This testimony shows (1) that of the total price of \$45,000 for goods to be delivered to Chula Vista approximately \$20,000 for goods actually delivered had been paid before the assignment of the note and at that time very little was owed by Chula Vista to La Casa (II-R. 14-15, 21-22); (2) after the assignment Chula Vista continued to pay cash for at least some of the subsequently delivered materials and labor (II-R. 26, 34-37) and all deliveries were completed in October or November, 1957 (II-R. 23; Ex. R-A, p. 12); (3) at the time of the delivery of the note in December, 1957 "very little" was owed to La Casa by Chula Vista (Ex. R-A, p. 41; I-R. 20); and (4) not only was La Casa unwilling to take the note rather than cash (II-R. 17-18, 45) but even Hedderich, who took the note, hoped to get cash rather than have to depend upon the note for payment (Ex. R-A, p. 38) and even now does not consider foreclosed the possibility of collecting directly, albeit slowly, from Al-

bachten, without regard to the note (Ex. R-A, pp. 38-39). This testimony really suggests that the bulk of the payments had been made before the note was ever delivered, and in light of the unwillingness of both of the Hedderichs to accept anything other than cash it is extremely unlikely that they would have completed the contract without having the note in hand unless they had already received cash for their work.<sup>6</sup>

Another interesting point brought out by the testimony is that the only consideration alleged to have passed between La Casa and Chula Vista is a pre-existing debt inasmuch as all of the work here involved had been completed by November, 1957, before delivery of the note. (II-R. 23; Ex. R-A, p. 12.) Under California law a pre-existing debt will be ade-

---

<sup>6</sup> For the purpose of this discussion it has been assumed that if consideration passed from La Casa to Chula Vista it could be treated as consideration for the note. However, it is very doubtful that this record would support such an assumption, which assumption clearly favors Hedderich. In fact the holder of the note, Jorge Hedderich, Jr., is not the owner of La Casa (II-R. 9) and describes himself as a "[m]anager and salesman in my father's store" (II-R. 4). Hedderich has never proven that materials and labor, even if advanced to Chula Vista, were advanced at his personal expense although he alleges, without proof, that he is personally responsible to La Casa for the alleged advances (II-R. 47) and yet has never paid anything to La Casa (II-R. 24). In addition, Albachten was not the personal recipient of any advances to Chula Vista since he was apparently only a manager (II-R. 5, 22) and not an owner of the company developing the subdivision (II-R. 30-32). Thus, even if Hedderich personally made advances to Chula Vista the consideration did not flow to Albachten and thus could not be consideration for the note.



quate consideration for a promissory note only where it is specifically so agreed between the parties. *Bramante v. Krug, supra*. In that case the court stressed the need for some tangible evidence that the note was accepted as payment for the pre-existing debt such as a discharge of the indebtedness of the transferee by the transferor. It also noted that the requirement was not met if the transferor treated the debt due until he had actually received cash for the note. Here, no evidence has been presented to prove any discharge and the above noted testimony of Hedderich (Ex. R-A, pp. 38-39) suggests strongly that he still feels the debt exists and will only be discharged when he actually receives the cash.

Thus, not only has Hedderich failed completely to carry his burden of proving that he took the note for adequate consideration but the record establishes clearly that no adequate consideration was given for the note and therefore, Hedderich is not entitled to actual notice under Section 6323(c), 1954 Code. The United States tax liens which were filed before either the assignment or the actual transfer of the note take priority over the claim of Hedderich. The District Court's findings of fact and conclusions of law embodying the foregoing are beyond challenge here.

## II

**Alternatively, the Service of a Tax Levy On a Debtor of the Taxpayer Entitled the United States To Recover Under Section 6332(b) of the Internal Revenue Code of 1954 the Amount of the Debt When It Came Due From the Debtor**

The second point is reached only if this Court should hold either that the assignment of July 30, 1957, from the taxpayer to Hedderich was a negotiable instrument, or that the finding of fact of the District Court to the effect that Hedderich did not give adequate and full consideration for the promissory note itself is clearly erroneous. In this posture, the Government argues that even if Hedderich has a right to payment on the note against the maker, Richards, nevertheless, Richards is liable to the United States for failure to honor a prior levy.

On September 13, 1957, the United States levied on all property of Albachten in the possession of Richards and by that levy Richards was obligated to give to the United States all such property if and when it came into his possession. (I-R. 25.) Section 6331 (a), 1954 Code, Appendix, *infra*. The United States levy resulted in "virtually a transfer to the government of the indebtedness". *United States v. Eiland*, 223 F. 2d 118, 121 (C. A. 4th); see also *Division of Labor Law Enforcement v. United States*, 301 F. 2d 82, 86 (C. A. 9th); *Kirby v. United States*, 329 F. 2d 735 (C. A. 10th). When, on July 6, 1961, the debt due Albachten of \$27,875 matured (I-R. 5) and Richards failed to pay it to the United States (I-R. 26) he became personally liable to the United States

for the amount of the debt plus 6 percent interest on the amount until paid. *Sims v. United States*, 359 U. S. 108, 114; *Hoye v. United States*, 277 F. 2d 116, 120 (C. A. 9th). The failure of the United States to physically seize the promissory note, did not impair its right to recovery here against Richards based on its levy of September 13, 1957. At the time of the levy, the note was merely an undelivered promissory note in the possession of the maker and as such was "incomplete and revocable" (Civil Code, Section 3097; see also *Rogers v. Harris*, *supra*; *Bogan v. Wiley*, *supra*) and was not property or a right to property belonging to the taxpayer which could be levied upon by the United States. Section 6331, 1954 Code. In fact an attempt to seize the note, which was not property of the taxpayer, could have been successfully defeated by Richards. See for instance, *Pool v. Walsh*, 282 Fed. 620 (C. A. 9th); *Stuart v. Chinese Chamber of Commerce of Phoenix*, 168 F. 2d 709 (C. A. 9th). Thus the United States did all it was legally entitled to do and cannot be prejudiced for failing to do that which it had no authority to do.<sup>7</sup>

---

<sup>7</sup> The District Court judge, with full opportunity to hear the testimony and assess the veracity and accurateness of the witnesses, found that the revenue agents' account of what transpired between themselves and Richards regarding the note, namely that Richards was specifically told to hold the note, was correct. (I-R. 25.) This purely factual determination should not be disturbed unless it is shown to be clearly erroneous. *Commissioner v. Duberstein*, 363 U. S. 278; *United States v. Gypsum Co.*, 333 U. S. 364, 395.



When the note was transferred by Richards to Albachten, Richards had full knowledge of the United States lien and levy and the import thereof (I-R. 25) and thus Richards assumed the consequences that might ensue; i.e., the possibility of double liability if the note should be negotiated to a holder in due course. Any other result would permit a person upon whom a levy had been made for a debt due from him to the taxpayer to defeat the levy by paying the debt to another after levy. The alleged note, not as yet delivered, was no more than a memorandum of the obligation of Richards to the taxpayer. Richards cannot defeat the United States by creating out of the memorandum a negotiable instrument that was not negotiable at the time of the levy and then discharging his debt to the taxpayer by delivery of the instrument to the taxpayer. Thus Richards became obligated to pay the debt due the taxpayer to the United States when it came due and his issuance of a promissory note for the debt to the taxpayer after the levy does not relieve him of that liability. Section 6332(b), 1954 Code, Appendix, *infra*.

CONCLUSION

For either of the reasons stated above, the judgment of the District Court should be affirmed.

Respectfully submitted,

RICHARD M. ROBERTS,  
*Acting Assistant Attorney General.*

LEE A. JACKSON,  
JOSEPH KOVNER,  
ANTHONY ZELL ROISMAN,  
*Attorneys,*  
*Department of Justice,*  
*Washington, D.C. 20530.*

*Of Counsel:*

MANUEL L. REAL,  
*United States Attorney.*

LOYAL E. KEIR,  
*Assistant United States Attorney.*

JANUARY, 1966

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Dated: ----- day of -----, 1966.

-----  
ANTHONY ZELL ROISMAN

## APPENDIX

## Internal Revenue Code of 1954:

## SEC. 6321. LIEN FOR TAXES.

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.

(26 U.S.C. 1958 ed., Sec. 6321.)

## SEC. 6323. VALIDITY AGAINST MORTGAGEES, PLEDGEEES, PURCHASERS, AND JUDGMENT CREDITORS.

(a) *Invalidity Of Lien Without Notice*—Except as otherwise provided in subsection (c), the lien imposed by section 6321 shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the Secretary or his delegate—

(1) *Under state or territorial laws*.—In the office designated by the law of the State or Territory in which the property subject to the lien is situated, whenever the State or Territory has by law designated an office within the State or Territory for the filing of such notice; or

\* \* \* \*

(c) *Exception In Case Of Securities.*—

(1) *Exception.*—Even though notice of a lien provided in section 6321 has been filed in the manner prescribed in subsection (a) of this section, the lien shall not be valid with respect to a security, as defined in paragraph (2) of this subsection, as against any mortgagee, pledgee, or purchaser of such security, for an adequate and full consideration in money or money's worth, if at the time of such mortgage, pledge, or purchase such mortgagee, pledgee, or purchaser is without notice or knowledge of the existence of such lien.

(2) *Definition of security.*—As used in this subsection, the term “security” means any bond, debenture, note, or certificate or other evidence of indebtedness, issued by any corporation (including one issued by a government or political subdivision thereof), with interest coupons or in registered form, share of stock, voting trust certificate, or any certificate of interest or participation in, certificate of deposit or receipt for, temporary or interim certificate for, or warrant or right to subscribe to or purchase, any of the foregoing; negotiable instrument; or money.

\* \* \* \*

(26 U.S.C. 1958 ed., Sec. 6323.)

SEC. 6331. LEVY AND DISTRRAINT.

(a) *Authority Of Secretary Or Delegate.*—If any person liable to pay any tax neglects or refuses to pay the same within 10 days after no-



tice and demand, it shall be lawful for the Secretary or his delegate to collect such tax (and such further sum as shall be sufficient to cover the expenses of the levy) by levy upon all property and rights to property (except such property as is exempt under section 6334) belonging to such person or on which there is a lien provided in this chapter for the payment of such tax. \* \* \*

\* \* \* \*

(26 U.S.C. 1958 ed., Sec. 6331.)

#### SEC. 6332. SURRENDER OF PROPERTY SUBJECT TO LEVY.

(a) *Requirement.*—Any person in possession of (or obligated with respect to) property or rights to property subject to levy upon which a levy has been made shall, upon demand of the Secretary or his delegate, surrender such property or rights (or discharge such obligation) to the Secretary or his delegate, except such part of the property or rights as is, at the time of such demand, subject to an attachment or execution under any judicial process.

(b) *Penalty For Violation.*—Any person who fails or refuses to surrender as required by subsection (a) any property or rights to property, subject to levy, upon demand by the Secretary or his delegate, shall be liable in his own person and estate to the United States in a sum equal to the value of the property or rights not so surrendered, but not exceeding the amount of the taxes for the collection of which such levy has been made, together with costs and interest on

such sum at the rate of 6 percent per annum from the date of such levy.

\* \* \* \*

(26 U.S.C. 1958 ed., Sec. 6332.)

Civil Code, 11 West's Annotated California Codes:

§ 3097. *Delivery; necessity; when effectual; presumption.*

Every contract on a negotiable instrument is incomplete and revocable until delivery of the instrument for the purpose of giving effect thereto. \* \* \* But where the instrument is in the hands of a holder in due course, a valid delivery thereof by all parties prior to him so as to make them liable to him is conclusively presumed. And where the instrument is no longer in the possession of a party whose signature appears thereon, a valid and intentional delivery by him is presumed until the contrary is proved.

§ 3111. *Negotiation defined.*

An instrument is negotiated when it is transferred from one person to another in such manner as to constitute the transferee the holder thereof. If payable to bearer it is negotiated by delivery; if payable to order it is negotiated by the indorsement of the holder completed by delivery.

§ 3133. *Holder in due course defined.*

A holder in due course is a holder who has taken the instrument under the following conditions:

\* \* \* \*

(3) That he took it in good faith and for value;

\* \* \* \*

§ 3136. *Defective title.*

The title of a person who negotiates an instrument is defective within the meaning of this title when he obtained the instrument, or any signature thereto, by fraud, duress, or force and fear, or other unlawful means, or for an illegal consideration, or when he negotiates it in breach of faith, or under such circumstances as amount to a fraud.

§ 3140. *Holder in due course; presumption; burden of proof.*

Every holder is deemed prima facie to be a holder in due course; but when it is shown that the title of any person who has negotiated the instrument was defective, the burden is on the holder to prove that he or some person under whom he claims acquired the title as holder in due course. \* \* \*





No. 20121, 20122

IN THE

# United States Court of Appeals

FOR THE NINTH CIRCUIT

---

FIDELITY AND DEPOSIT COMPANY OF MARYLAND  
and L. E. DIXON COMPANY,

*Appellants,*

*vs.*

VAN HARRIS, an individual, doing business as Harris & Sons,

*Appellee.*

---

FIDELITY AND DEPOSIT COMPANY OF MARYLAND  
and L. E. DIXON COMPANY,

*Appellants,*

*vs.*

PARAMOUNT TRUCK RENTAL, INC., and VAN HARRIS,  
an individual doing business as Harris & Sons,

*Appellees.*

---

PARAMOUNT TRUCK RENTAL, INC.,

*Appellant,*

*vs.*

FIDELITY AND DEPOSIT COMPANY OF MARYLAND  
and L. E. DIXON COMPANY,

*Appellees.*

---

On Appeal From the United States District Court for the  
Southern District of California, Central Division.

---

## REPLY BRIEF OF APPELLEE PARAMOUNT TRUCK RENTAL, INC.

---

GREENBERG & GLUSKER,  
RICHARD H. FLOUM,

9720 Wilshire Boulevard,  
Beverly Hills, California,

*Attorneys for Appellee Paramount  
Truck Rental, Inc.*

**FILED**  
**AUG 20 1965**  
FRANK H. SCHMID, CLERK



## TOPICAL INDEX

	Page
I.	
Jurisdictional statement .....	1
II.	
Statement of case .....	2
III.	
Statutes involved .....	8
IV.	
Questions presented .....	8
V.	
Summary of argument .....	9
VI.	
Argument .....	10
A. For purposes of the Miller Act, Dixon is to be treated as the prime contractor .....	10
B. The Miller Act protects all persons who agree to perform and, in fact, do perform any part of the work of public construction whatever their relationship be with the prime contractor .....	15
C. Paramount had a direct contractual relation- ship with Dixon express and implied, and, hence, has standing to sue on the Miller Act bond in question .....	18
D. For the purposes of the Miller Act Harris is only a paper contractor who must be ignored and Yost therefore must be treated as a subcontractor to the prime contractor, Dixon .....	21
Conclusion .....	28

## TABLE OF AUTHORITIES CITED

Cases	Page
Basich Bros. Const. Co. v. United States, 150 F. 2d 182 .....	15
Bushman Construction Co. v. Conner, 307 F. 2d 888..	26
Clay v. Walton, 9 Cal. 328 .....	19
Clifford F. MacEvoy Co. v. United States, 322 U.S. 102, 64 S. Ct. 890, 88 L. Ed. 1163 .....	14, 15, 16, 17, 22, 23, 25
Continental Casualty Co. v. United States, 308 F. 2d 846 .....	25
Fine v. Travelers Indemnity Co., 233 F. Supp. 672 .....	23, 27
Fleisher Engineering Co. v. United States, 311 U.S. 15 .....	28
Glassell-Taylor Co. v. Magnolia Petroleum Co., 153 F. 2d 527 .....	27
Kilbride v. Moss, 113 Cal. 432, 45 Pac. 812 .....	18
McGregor Architectural Iron Co. v. Merritt-Chapman & Scott Corp., 150 F. Supp. 323 .....	15, 17
Noland Co. v. Allied Contractors, Inc., 273 F. 2d 917 .....	20
Polliana Homes v. Berney, 56 Cal. 2d 676, 365 P. 2d 401 .....	19
Realty Corp. v. Burton, 162 Cal. App. 2d 44, 327 P. 2d 948 .....	19
Sam Macri & Sons v. U. S. A., 313 F. 2d 119 .....	15
Tobola v. Wholey, 75 Cal. App. 2d 351, 170 P. 2d 952 .....	19



	Page
Triangle Electric Supply Co. v. Mojave Electric Co., 234 F. Supp. 293 .....	14, 29
United States v. Aetna Cas. & Surety Co., 56 F. Supp. 431 .....	27
United States v. Bregman Construction Corp., 172 F. Supp. 517 .....	20
United States v. Carter, 353 U.S. 210, 1 L. Ed. 2d 776 .....	20, 28
United States v. Ft. George G. Meade, etc., 186 F. Supp. 639 .....	24, 25, 27
United States v. Harder Industrial Contractors, Inc., 225 F. Supp. 699 .....	12, 14
United States v. Kelley, 327 F. 2d 590 .....	20
United States v. Phoenix Assurance Co. of New York, 163 F. Supp. 713 .....	11, 12

#### Statutes

Civil Code, Sec. 1624(2) .....	18
49 Statutes at Large (1935), p. 793 .....	8
73 Statutes at Large (1959), p. 279 .....	8
United States Code, Title 40, Sec. 270(a) .....	8, 10
United States Code, Title 40, Sec. 270(b) .....	20

#### Textbooks

24 American Jurisprudence, Sec. 3 .....	18
23 California Jurisprudence 2d, Sec. 81 .....	18
23 California Jurisprudence 2d, Secs. 131-132 .....	19
1 Witkin, Summary of California Law, Sec. 100 ..	18
1 Witkin, Summary of California Law, Sec. 108 ....	19



No. 20121, 20122

IN THE

# United States Court of Appeals

FOR THE NINTH CIRCUIT

---

FIDELITY AND DEPOSIT COMPANY OF MARYLAND  
and L. E. DIXON COMPANY,

*Appellants,*

*vs.*

VAN HARRIS, an individual, doing business as Harris & Sons,

*Appellee.*

---

FIDELITY AND DEPOSIT COMPANY OF MARYLAND  
and L. E. DIXON COMPANY,

*Appellants,*

*vs.*

PARAMOUNT TRUCK RENTAL, INC., and VAN HARRIS,  
an individual doing business as Harris & Sons,

*Appellees.*

---

PARAMOUNT TRUCK RENTAL, INC.,

*Appellant,*

*vs.*

FIDELITY AND DEPOSIT COMPANY OF MARYLAND  
and L. E. DIXON COMPANY,

*Appellees.*

---

On Appeal From the United States District Court for the  
Southern District of California, Central Division.

---

## REPLY BRIEF OF APPELLEE PARAMOUNT TRUCK RENTAL, INC.

---

### I.

### JURISDICTIONAL STATEMENT.

Appellee adopts the jurisdictional statement contained in the Opening Brief of Appellants L. E. Dixon Company (hereafter "Dixon") and Fidelity and Deposit Company of Maryland (hereafter "Fidelity").

## II.

### STATEMENT OF CASE.

The relevant documentary and oral evidence adduced at the trial of this action shows and the Court below found as follows:

1. On or about December 22, 1961, the United States of America through the National Aeronautics and Space Administration (hereafter NASA) entered into a written contract [Pltf. Ex. 1] with California Institute of Technology (hereafter CIT) whereunder CIT agreed to operate the Jet Propulsion Laboratory at Pasadena, California (hereafter JPL) and to furnish all the scientific, engineering, technical and other personnel, labor and services necessary for the management and operation thereof [Pltf. Ex. 1, p. 3]. Page 4 of said contract describes the services CIT agrees to render once the proposed laboratory is completed and subparagraph 2 on page 4 thereof provides that CIT "may, when authorized by Task Orders or Task Order Amendments, enter into subcontracts for the construction of facilities authorized by approved Construction of Facilities Projects."

2. On or about June 18, 1962, pursuant to a task order issued by NASA, CIT entered into a written contract with Dixon by the terms of which Dixon agreed to construct the Central Engineering Building at JPL [Pltf. Exs. 7 and 8]. Part 1, division 4, page 5 of plaintiff's Exhibit 8 specifically requires that Dixon furnish a Surety Bond to secure "payment in full of the claims of all persons performing labor upon or furnishing materials to be used in the construction of the building, . . ."



Part III, Div. 2, p. 24, of the Specifications [Pltf. Ex. 8] of the contract between CIT and Dixon provides that “all subcontractors, manufacturers or suppliers’ equipment used in or a part of the work . . . shall be deemed obtained by CIT as the Agent of the Government.”

3. Thereafter, and in compliance with said bonding requirement, Dixon, as principal, and Fidelity, as surety, executed a payment bond [Pltf. Ex. 2] in the amount of approximately \$2,500,000 binding themselves to “promptly make payment to all persons supplying labor and material in the prosecution of the work provided for” in Dixon’s contract with CIT. The United States and CIT are named as joint obligees on said bond.

4. Thereafter, on or about June 18, 1962, Dixon prepared and sent to Mr. Van Harris, doing business as Harris and Sons (hereafter “Harris”) its proposed written subcontract [Pltf. Ex. 3] whereunder Harris is to furnish all labor, material and equipment and perform all work necessary to complete demolition, rough grading, excavating, fills and backfilling concerning the proposed Central Engineering Building at JPL for a total price of \$22,900. Paragraph 11 of that contract provides: “Subcontractor agrees whenever notified by the Contractor (either before the commencement of the work or at any time during the progress of the work) to furnish to the contractor a Faithful Performance and Labor and Material Bond in favor of the Contractor and in an amount equal to the specified sum to be paid by the Contractor to the Subcontractor under this Subcontract, which bond shall be given by the Subcontractor as principal and a corporate surety licensed

and authorized by law to write and issue such bonds in the State where the work is to be performed; the premium on said bond may be added to the sum due to the Subcontractor under this Subcontract". Dixon did not require Harris to furnish such a bond to it.

5. On or about June 20, 1962, Harris returned by mail to Dixon its subcontract signed by him, along with Harris' letter of even date [Pltf. Ex. 5] stating in part:

"I also explain that for the furtherance of the completion, it would be necessary to have one sub-contractor on this project and as there were no objections, I have made arrangements for this. With this letter attached to and a part of this sub-contract, I inclose (sic) herewith, the signed yellow copy [of the Dixon subcontract] as requested."

Harris had informed Dixon prior to sending this letter that he intended to use one subcontractor on the project [Reporter's Transcript (hereafter R. T.) pp. 28-29].

6. Approximately two weeks prior to sending this letter [Pltf. Ex. 5] to Dixon, Harris had negotiated with Andrew Yost (hereafter "Yost") an agreement whereby Yost agreed to do all the work that Harris subsequently contracted to do for Dixon for \$16,525 or approximately \$6,500 less than Harris' price to Dixon [R. T. pp. 104-105; 31-32].\* Contrary to the assertion contained in the Opening Brief (page 3, second full paragraph) the trial court found and the evidence

---

\*Appellants Dixon and Fidelity concede in their opening brief (hereafter Opening Brief) page 3, second full paragraph, lines 3-5, as they must, that "Yost agreed to perform all the physical work which Harris had agreed to perform for Dixon."

supports the finding that Harris had entered into the written agreement [Pltf. Ex. 4] with Yost *prior* to sending back a signed copy of the Dixon contract [Clerk's Transcript (hereafter C. T.) p. 164, lines 2-7; and see R. T. citations in paragraph 6 above].

7. In early July, 1962, Yost and Use plaintiff, Paramount Truck Rental, Inc., (hereafter "Paramount") with which it had orally contracted to supply machinery and labor necessary for Yost to perform his contract with Harris, commenced to work on the job site [R. T. pp. 99, 54, 106].

8. When Yost commenced work on the job site Harris introduced him to Mr. Meyer, the job superintendent for Dixon, as the one who was to be in charge of the work [R. T. 108, lines 9-19; C. T. p. 166, lines 15-17]. Yost or McFarland, a Paramount employee who was the foreman on the job site, or both of them, thereafter daily dealt with Meyer and Meyer never requested that either of them go through Harris [R. T. pp. 97, 109, 101].

9. Dixon learned within a week after work commenced on the job site that Yost was working there under a contract with Harris and not as an employee thereof. [C. T. p. 166, lines 17-19, R. T. pp. 113-114, 126-127].

10. Although Harris was occasionally on the job site [R. T. p. 100] appellants' completely misstate the facts when they baldly assert he was there "supervising". (Op. Br. p. 3, line 2 of the last full paragraph). Indeed, Harris himself was frank to testify and the court below found that he "had no control over Mr. Yost" [R. T. p. 46, line 24; pp. 93-94; C. T. p. 164, lines 7-9] and Mr. McFarland testified that he dealt

only with Mr. Meyer, Dixon's job superintendent or with Mr. Yost, taking his instructions only from either of these gentlemen and not from Mr. Harris [R. T. pp. 98-99]. In the event of any dispute with Dixon, McFarland would go to Yost for it to be straightened out [R. T. p. 101].

11. Harris performed no part of his contract with Dixon. Harris' contractual obligations were performed solely by Yost, or by Paramount, until a dispute later arose with Dixon. [C. T. p. 166, lines 19-22; R. T. pp. 37, line 22, to p. 38, line 13; pp. 107, 100-101, 110-112, 74-81]. Defendant's own documents admit this fact. Thus, Plaintiff Exhibit 9, a letter from Dixon to Harris dated 10-3-62, states in part:

*"We have requested from you . . . releases from the parties who have heretofore performed all of the actual work completed to date on the site of the subject project."* (emphasis supplied)

And Plaintiff's Exhibit 15, a letter from Dixon to Yost, states that Paramount ". . . has forwarded to us invoices and supporting documents for equipment used by you in the performance of the subcontract, which is held by Van Harris & Son, for the excavation and backfill work in connection with the construction . . ."

12. In August or September, 1962, a dispute arose between Paramount, Yost and Harris, on the one hand, and Dixon, on the other, concerning Dixon's demand for material and equipment releases from Paramount and Yost "the parties who have heretofore performed all of the actual work completed to date on the site of the subject project" as a condition precedent to making



any further progress payments. [Pltf. Ex. 9, and R. T. pp. 74-81]. As a consequence of the foregoing, Yost and Paramount refused to perform further and walked off the job.

13. However, in October, 1962, Paramount was contacted by Meyer, Dixon's job superintendent, with the request that Paramount deliver some equipment to the job site. Meyer specifically agreed that Dixon would pay the bill for the rental of such equipment if Paramount did not receive payment therefor from Yost. [R. T. pp. 65-67]. In reliance on this promise, Paramount did send equipment to the job site and thereafter did directly bill Dixon [Pltf. Ex. 14], but Dixon failed and refused to pay same, referring Paramount to Yost for payment [Pltf. Ex. 15].

14. Within the time permitted by law, Paramount sent the requisite Miller Act notice to, *inter alia*, Dixon and Fidelity [Pltf. Ex. 16].

15. Ample oral and documentary evidence was introduced by Paramount [Pltf. Ex. 12-14, 17 and R. T. pp. 54-60, 89-92] from which the court could find, and did find, what work was performed by Paramount on the job site, what was the reasonable value of such work, and what was the unpaid balance due on such work. Based upon this evidence the court below entered its Judgment in favor of Paramount and against Dixon and Fidelity, jointly and severally, in the sum of \$8,-730.87, together with interest thereon at the rate of 7% per annum from October 11, 1962 to March 23, 1965, and costs in the sum of \$69.42 [C. T. pp. 177-178] from which Judgment Fidelity and Dixon appeal.

### III.

#### STATUTES INVOLVED.

The applicable sections of the Miller Act, 40 U.S.C. Section 270a, 49 Stat. 793 (1935), as amended, 73 Stat. 279 (1959), which appellee submits is the only statute involved herein, are set forth at pages 5-8 of the Opening Brief herein.

### IV.

#### QUESTIONS PRESENTED.

A. For the purposes of the Miller Act, is Dixon, the Company which furnished the Miller Act bond at issue herein and which contracted to act as general contractor for the construction of the Central Engineering Building at JPL, to be treated as the prime or general contractor under said Act or merely as the first subcontractor by reason of its contract with CIT.

B. Does the Miller Act cover only suppliers or subcontractors who have either a contractual relationship, express or implied, with the contractor furnishing the payment bond or with one of such contractor's subcontractors or does it extend to all subcontractors who actually perform part of the work of construction?

C. Did Paramount have a contractual relationship with Dixon express or implied by reason of (i) the express contract entered into between them in October (see Statement of Case, Paragraph 13, *supra*), or (ii) by reason of its relationship therewith on the job site?

D. Was Harris, who admittedly did not perform any part of his contract with Dixon, merely a "paper subcontractor" who for purposes of the Miller Act, is to be excluded from consideration so that Yost, the party

who along with Paramount performed all of the work done under Harris' subcontract, becomes a subcontractor of Dixon's rather than a sub-subcontractor thereof and Paramount a person having a direct contractual relationship with such a subcontractor.

## V.

### SUMMARY OF ARGUMENT.

A. Dixon, the company that supplied the subject performance bond and that contracted to construct the Central Engineering Building of JPL, is to be treated as the prime or general contractor for the purpose of determining whether or not Paramount had a sufficient nexus therewith to recover under the Miller Act. CIT was nothing more than the supervisory agent of NASA and is not to be considered as the prime or general contractor.

B. The Miller Act does not limit its protection only to suppliers or contractors who have either a contractual relationship, express or implied, with the contractor furnishing the payment bond or with one of such contractor's subcontractors but rather protects all subcontractors who agree to perform and, in fact, do perform any part of the work on the construction project.

C. Paramount's direct contractual relationship with Dixon in October brings *all* of the work done by Paramount on the job site under the protection of the Miller Act. Moreover, even absent the October agreement, there was an implied direct contractual relationship between Paramount and Dixon by reason of their respective activities on the job site, which affords Miller Act protection to Paramount.

D. Since Harris did not, in fact, perform any part of the work on the construction project, he was a mere “paper contractor” who, for Miller Act purposes, must be excluded from consideration, so that for purposes of determining whether there was a sufficient nexus between Paramount and Dixon, Yost’s relationship with Dixon must be telescoped to make Yost a subcontractor of Dixon and Paramount then becomes a person having a direct contractual relationship with such a subcontractor.

## VI. ARGUMENT.

### A. For Purposes of the Miller Act, Dixon Is to Be Treated as the Prime Contractor.

The Miller Act provides in part (40 U.S.C. Section 270a) that:

*“Before any contract, exceeding \$2,000 in amount, for the construction, alteration, or repair of any public building of the United States is awarded to any person, such person shall furnish to the United States the following bonds, which shall become binding upon the award of the contract to such person, who is hereinafter designated as ‘contractor’:*

*“... ”*

*“(2) A payment bond with the surety or sureties satisfactory to such officer [the officer awarding such contract] for the protection of all persons supplying labor and material in the prosecution of the work provided for in said contract for the use of each such person . . .”* (Emphasis supplied).

As demonstrated in the statement of the case, *supra*, the contract to construct the Central Engineering Building at JPL was awarded by CIT to Dixon, after first securing from NASA the requisite task order. Since Dixon was awarded a contract to construct a public building within the meaning of the Miller Act, under the specific terms thereof, Dixon, not CIT, was required to post the requisite payment bond and, of course, by statutory definition Dixon became the contractor. Indeed, in the words of the Trial Court:

“It seems clear that NASA was treating C.I.T. as its supervisory agent and that Dixon was treated as its prime contractor in connection with the performance of the work outlined in its contract with C.I.T., the only contract between the government and C.I.T. was the Research Development contract; the construction contract was entered into between Dixon and C.I.T. pursuant to the general terms of the R & D contract authorizing the building of facilities by C.I.T. when authorized by the proper governmental representative.” [C. T. p. 165, lines 9-17].

The nature of the work to be performed and not the name of the contracting party determines whether or not the bond in question is a Miller Act bond. In *United States v. Phoenix Assurance Co. of New York*, 163 F. Supp. 713 (N.D. Cal. 1958), Judge Oliver J. Carter held that a payment bond furnished to secure the construction of a new post library at the Presideo Army Base in San Francisco pursuant to a contract with the “Special Facility Fund, Building 220, Presidio of San



Francisco, California, a non-appropriated fund activity.” was a Miller Act Bond declaring:

“The test is not whether there was a formal contract in the name of the United States, but whether there was a contract ‘for the construction . . . of any public building or public work of the United States’. If the person or agency making the contract for the public building, or public work, on behalf of the United States had the authority to so contract, it is immaterial whether the contract is made in the name of the United States or of such person or agency.”

Moreover, it is equally clear both from the *Phoenix Assurance Co.* case and the case of *United States v. Harder Industrial Contractors, Inc.*, 225 F. Supp. 699 (D. Ore. 1963) that the person who contracts to build a public building with either the United States or its agent (in our case CIT) and thereafter supplies the requisite payment bond is the prime or general contractor under the Miller Act for the purpose of determining whether or not a person who seeks to recover on such a bond has a sufficient nexus therewith.

In *Harder*, the United States of America acting through one of its arms (there, the Atomic Energy Commission) entered into a contract with Henry J. Kaiser (Kaiser Engineers Division), a Nevada corporation, for the erection of certain facilities near Richland, Washington. Kaiser as “contractor” thereafter let out bids for the performance of certain work included in the contractor’s agreement with the A.E.C. In compliance with the requirements of the contract, Harder, as principal, and General Insurance Co. of America, as surety, posted a payment bond naming

the United States of America and Kaiser as joint obligees thereunder.\* Defendants argued that the bond in question was not a Miller Act bond for the following reasons:

“(1) The Miller Act requires the bond of the prime contractor, rather than the subcontractor, such as Harder, and

(2) The United States must be the sole obligee under a Miller Act bond.”

District Judge Kilkenny ruled against defendants on both contentions, reasoning as follows:

Firstly, in respect to the position that the United States must be the only person on such a bond in order for it to be a Miller Act bond, the court held: “I can think of no valid reason why the addition of an obligee should destroy the force and effect of an otherwise valid Miller Act bond. If necessary, the name of the other obligee could well be ignored and treated as mere surplusage” [225 F. Supp. 699 and see C. T. pp. 175-176].

In respect to defendants’ other argument, *i.e.*, that the Miller Act requires a bond of the prime contractor rather than the subcontractor, Judge Kilkenny reasoned as follows:

“The language of the Miller Act, in itself, does not indicate such a conclusion. On the other hand, it has been held that the Act should be liberally construed in favor of those persons who supply material toward the prosecution of the work. *United States for Benefit and on Behalf of Sherman v.*

---

\*Likewise, in the instant case, the United States and CIT are named under the bond (Pltf. Ex. 2) as joint obligees.

*Carter et al.*, 353 U.S. 210, 77 S.Ct. 793, 1 L.Ed 2d 776 (1957).

The primary purpose of the Miller Act is to protect those who furnish labor or supply material for use in the construction of public buildings or public works of the United States and a liberal construction should be given to effectuate that purpose."

Finally, Judge Kilkenny added in words which are clearly apposite to the instant case:

"It seems rather clear that the Commission was treating Kaiser Engineers as its supervisory agent and that Harder was treated as the prime contractor in connection with the performance of the work outlined in its contract. I conclude that the bond was posted pursuant to the provisions of the Miller Act." (225 F. Supp. at 702).

*Harder* also patently stands for the proposition that for the purpose of the Miller Act, the person who furnishes the performance bond is to be treated as the contractor for the purpose of determining whether or not the use plaintiff has a sufficient nexus therewith. Since plaintiff there was only the supplier of a subcontractor of Harder's, it would appear that under the *MacEvoy* rule (discussion occurs *infra*, pages 15-17), if the A.E.C. had been treated as the prime or general contractor, plaintiff would not have been entitled to recover on the Miller Act bond, since it then only would have been the supplier of a sub-subcontractor which, under *MacEvoy*, is probably outside the purview of the Miller Act.

And see also *Triangle Electric Supply Co. v. Mojave Electric Co.*, 234 F. Supp. 293 at 308-09 (W.D. Mo. 1964).

Thus, both the unequivocal language of the Miller Act itself and decisional law compel a holding that for purposes of this action, Dixon was and must be treated as the general or prime contractor.

**B. The Miller Act Protects All Persons Who Agree to Perform and, in Fact, Do Perform Any Part of the Work of Public Construction Whatever Their Relationship Be With the Prime Contractor.**

Appellee is frank to admit that at least one Circuit Court of Appeals, the 5th Circuit, and a handful of federal district courts have held that the Supreme Court decision in *Clifford F. MacEvoy Co. v. United States*, 322 U.S. 102, 64 S. Ct. 890, 88 L. Ed. 1163 (1944) requires one who seeks to come within the purview of the Miller Act, first to establish that he had either a direct contractual relationship with a first tier subcontractor or a contractual relationship, express or implied, with the contractor furnishing the payment bond. But insofar as appellee is aware, this honorable court has not ruled on the question.\* In light of this fact, it is respectfully suggested that this court should adopt the rule laid down by District Judge Follmer, in *McGregor Architectural Iron Co. v. Merritt-Chapman & Scott Corp.*, 150 F. Supp. 323 (M.D. Pa. 1957). There, Judge Follmer held that a third-tier subcontractor, *i.e.*, one who had contracted with a sub-subcontractor to perform part of the work on the job site and in fact, did perform such work was protected under the Miller Act.

---

\*The question is not reached by this court in *Basich Bros. Const. Co. v. United States*, 150 F. 2d 182 (9th Cir. 1946), nor in *Sam Macri & Sons v. U. S. A.*, 313 F. 2d 119 (9th Cir. 1963).

Judge Follmer reasoned:

“The MacEvoy case is clearly distinguishable. In that case MacEvoy, the prime contractor, purchased from Miller certain building materials for use in the prosecution of the work provided for in MacEvoy’s contract with the Government. Miller in turn purchased these materials from Tomkins. Miller failed to pay Tomkins. There was no allegation that Miller agreed to perform or did perform any part of the work on the construction project. The Court spelled out the issue as to whether under the Miller Act a person supplying materials to a materialman of a Government contractor and to whom an unpaid balance is due from the materialman can recover on the payment bond executed by the contractor. The Court held that he cannot.” (150 F. Supp. at 324-325)

Judge Follmer also quotes *MacEvoy’s* definition of a Miller Act subcontractor, *viz.*: “Under the more technical meaning, as established by usage in the building trades, a subcontractor is one who performs for and takes from the prime contractor a specific part of the labor or material requirements of the original contract, thus excluding ordinary laborers and materialmen.” (150 F. Supp. at 325)

As a consequence of the foregoing, and based upon this distinction Judge Follmer concluded:

“In the instant case, the plaintiff, the third subcontractor, performed two contracts, one for the erection of a bunker, the other for the erection of a stiff leg post and three bridlepsts, both of



which were an actual part of the Tobyhanna job and were performed on the site by the plaintiff.

*It seems to me that plaintiff certainly qualifies under the wording of the MacEvoy case as one of 'the relatively few subcontractors who perform part of the original contract' and who accordingly 'represent in a sense the prime contractor and are well known to him'. The plaintiff here was not 'an ordinary materialman'.*

I find nothing in the Act which would preclude a subcontractor actually performing on the site an integral part of the main contract which was the responsibility of the prime contractor from the beneficent provisions of this Act. As a matter of fact, a study of the legislative history of this Act taken with the expressed view of the Supreme Court in the MacEvoy case that it is to be given a liberal interpretation convinces me that this third subcontractor plaintiff is within the group entitled to protection under the Act." 150 F. Supp. at 326; (Emphasis supplied).

It is respectfully submitted that Judge Follmer's reasoning is persuasive and carries out the broad statutory language and admitted remedial purpose of the Miller Act. That language on its face covers "every person who has furnished labor or material in the prosecution of the work provided for in such contract [*i.e.*, to construct a public building]."

*MacEvoy* should be limited to its peculiar facts as Judge Follmer does in the *McGregor* case which, appellee respectfully submits, is worthy of adoption by this honorable court.

**C. Paramount Had a Direct Contractual Relationship With Dixon Express and Implied, and, Hence, Has Standing to Sue on the Miller Act Bond in Question.**

The court below properly found that Paramount furnished equipment to Dixon during October 1962 “upon the direct request of Dixon to Paramount.” [C. T. p. 167, line 32, to p. 168, line 3]. Appellants do not dispute the efficacy of this finding but instead argue that the court erred in permitting the introduction of this evidence by reason of the California Statute of Frauds. (Cal. Civil Code § 1624(2)) (See Op. Br. pp. 23-24).

But the argument of appellants again completely misses the mark since what was at issue in the October situation was not a promise on the part of Dixon to answer for an obligation already existing from Yost to Paramount but rather an independent, sole and newly created obligation on the part of Dixon. For prior to Dixon’s ordering the work in question from Paramount, Paramount was not required to do such work for Yost nor, of course, did Yost have an obligation to Paramount to pay for such work once done.

This being the case, Dixon’s promise to Paramount is not a promise “to answer for the debt, default or mis-carriage of another . . .” (Cal. Civ. Code §1624(2)) and is hence not within the Statute of Frauds.

*Kilbride v. Moss*, 113 Cal. 432, 45 Pac. 812 (1896);

23 Cal. Jur. 2d *Frauds, Statutes of*, Sec. 81;

1 Witkin, *Summary of Cal. Law*, Contracts, Sec. 100;

24 Am. Jur., *Guaranty*, Sec. 3.

*Clay v. Walton*, 9 Cal. 328 (1858), relied on by Appellants, is clearly distinguishable by reason of the fact that there, in fact, a contract was entered into between plaintiff and the person for whom defendant orally promised he would be responsible should that person fail to live up to his contract. Here, on the other hand, there is no evidence in the record, nor could there be, that a contract was entered into between Yost and Paramount in respect to the work ordered by Dixon in October. This being the case, Dixon's promise to pay for such work is primary and unconditional and, hence, under the authorities cited above not within the Statute of Frauds.

Moreover, and in any event:

"Since the Statute of Frauds is a 'shield' and not a 'sword', *i.e.*, a defense and not a basis for affirmative action . . . it cannot be used to attack an oral contract which has been fully performed."

1 Witkin, *Summary of California Law*, Contracts, Section 108, and cases cited therein.

Accord,

*Polliana Homes v. Berney*, 56 Cal. 2d 676, 365 P. 2d 401 (1961);

*Realty Corp. v. Burton*, 162 Cal. App. 2d 44, 57, 327 P. 2d 948 (1958);

*Tobola v. Wholey*, 75 Cal. App. 2d 351, 357, 170 P. 2d 952 (1946);

23 Cal. Jur. 2d, Frauds, Statutes of, §§ 131-132.

Having established that there was a direct contractual relationship between Paramount and Dixon in October, 1962, the question then becomes, whether this contractual relationship can relate back and cover all of the work that Paramount did for Yost, so that there

would be the requisite contract between Paramount and Dixon under §270b which would sweep all of the work performed by it under the protection of the Miller Act.

While appellee has not found a case squarely in point, it has found a case which it believes presents a persuasive and controlling analogy. In *Noland Co. v. Allied Contractors, Inc.*, 273 F. 2d 917 (4th Cir. 1959) the court held that where a materialman furnished materials from time to time on separate orders, notice to the prime contractor given within ninety days from the date of the delivery under the *last* order was timely as to *all* deliveries in an action brought under the Miller Act, the court reasoning:

“The notice provision as to the subcontractor in the Miller Act, . . . speaks of a *contractual relationship* between the contractor and the subcontractor, which is broad enough to cover a series of separate contracts or orders relating to the same project” (273 F. 2d at 920).

Accord:

*United States v. Bregman Construction Corp.*,  
172 F. Supp. 517, 522 (E.D.N.Y. 1958).

It is respectfully submitted that the above authorities present a strong analogy to support a holding by this honorable court, particularly in light of the clear remedial aspect of the Miller Act which requires that it be liberally construed (see *e.g.*, *United States v. Carter*, 353 U.S. 210, 1 L. Ed. 2d 776 (1957); *United States v. Kelley*, 327 F. 2d 590 (9th Cir. 1964)) that there

was the requisite direct contractual relationship between Dixon and Paramount.

Secondly, appellee contends that even ignoring the October contract between Dixon and Paramount, there was such a relationship between Mr. McFarland, the Paramount employee and superintendent on the job, and Mr. Meyer, the Dixon job superintendent [R. T. pp. 97, 102, 107-109, 93-94, 37-38] that an implied contract arose between Dixon and Paramount within the meaning of the Miller Act. This is so because on numerous occasions on the job site Meyer and McFarland dealt directly and face to face, McFarland taking instructions directly from Meyer where, on numerous occasions, neither Yost nor, of course, Harris were present.

**D. For the Purposes of the Miller Act Harris Is Only a Paper Contractor Who Must Be Ignored and Yost Therefore Must Be Treated as a Subcontractor to the Prime Contractor, Dixon.**

As set forth above in the statement of the Case, the facts are and the court found that Harris, although it purported to contract with Dixon to do a portion of the work which Dixon was to perform under its contract with CIT, in fact did no such work but, rather "subcontracted" all of that work to Yost which, in fact, with the aid of Paramount did all such work that was performed on the job. This section of the reply brief shall discuss whether or not in light of these facts and for the purposes of the Miller Act, Harris should be ignored and Yost should be treated as Dixon's subcontractor.



*MacEvoy Co. v. United States, supra*, relied on most heavily by Dixon and Fidelity herein, contains a learned discussion of what is meant by the term “subcontractor” as used in the Miller Act. That discussion has particular relevance to the case at hand and is as follows:

“The Miller Act itself makes no attempt to define the word ‘subcontractor’. We are thus forced to utilize ordinary judicial tools of definition. Whether the word includes laborers and materialmen is not subject to easy solution, for the word has no single, exact meaning. In a broad, generic sense a subcontractor includes anyone who has a contract to furnish labor or material to the prime contractor. In that the sense Miller was a subcontractor. *But under the more technical meaning, as established by usage in the building trades, a subcontractor is one who performs for and takes from the prime contractor a specific part of the labor or material requirements of the original contract, thus excluding ordinary laborers and materialmen.* To determine which meaning Congress attached to the word in the Miller Act, we must look to the Congressional history of the statute as well as to the practical considerations underlying the Act.

*It is apparent from the hearings before the subcommittee of the House Committee on the Judiciary leading to the adoption of the Miller Act that the participants had in mind a clear distinction between subcontractors and materialmen. . . .”* (Emphasis supplied).

Thus, the pivotal question under *MacEvoy* in determining Miller Act status, is not whether there is a contract with the prime contractor, but whether the

contracting party in fact “performs for and takes from the prime contractor a specific part of the labor or material requirements of the original contract”. If it does not do so, then it is not to be treated as a subcontractor, no matter what its paper relationship with the general or prime contractor be.

A number of cases have so held.

Thus, in *Fine v. Travelers Indemnity Co.*, 233 F. Supp. 672 (W.D. Mo. 1964). S. S. Silberblatt, Inc. contracted with the United States to construct certain military housing and furnished, as principal, the requisite Capehart Act bond, Miller Act standards being expressly made applicable thereto. Under that bond, and under the restrictive interpretation some events have given to *MacEvoy*, only persons who have a direct contract with the principal (*i.e.*, Silberblatt) or with a subcontractor of the principal and who have furnished labor and material in the prosecution of the work provided for in the contract are entitled to recover. Silberblatt subcontracted a portion of its contract to Sterling Brukar, Inc. who in turn subcontracted a portion of its work to W. S. Conner, the latter, in turn, contracting with plaintiff who supplied labor and materials for which it sued to recover under the bond.

The court quite properly reasoned that:

“MacEvoy held that a ‘subcontractor . . . [within the] meaning Congress attached to the word in the Miller Act . . . is one who performs for and takes from the prime contractor a specific part of the labor or material requirements of the original contract.’ *It would follow that one who does not, in a very real sense, ‘perform for’ and who does not, in a very real sense, ‘take from’ the prime*

*contractor a specific part of the contract is one who is something other than a 'subcontractor', within the meaning of the Miller Act."* (233 F. Supp. at 679; emphasis supplied).

The court, applying this test, held that plaintiff was entitled to recover on the bond because Brukar was not a real Miller Act subcontractor since it "*did not in fact take from and perform a specific part of the labor or material requirements of the original contract in a manner consistent with the established usage in the construction industry, within the meaning of a 'subcontractor' as defined either in the Capehart Bond or in the Miller Act as explained in MacEvoy*", even though:

"certain moneys were routed through the corporate books of Sterling Brukar, Inc. . . ." (233 F. Supp. at 681-82).

Likewise applicable is *United States v. Ft. George G. Meade, etc.*, 186 F. Supp. 639 (D.Md. 1960). There, Miller, the prime contractor purported to subcontract its *entire* contract to McCloskey who in turn subcontracted a portion of its contract to Sunbeam. Sunbeam then purchased materials for the job from Acme, the use plaintiff therein. Defendant argued in a suit on the Capehart Act bond, that since plaintiff had no contractual relationship either with the alleged principal, Miller, or with Miller's alleged first subcontractor, McCloskey, it therefore did not have standing to sue on the bond in question. But the court held that if plaintiff could prove that McCloskey was really the prime contractor, *either* by showing the existence of a joint venture *or a complete assignment of Miller's responsibilities to McCloskey*. For then Sunbeam would become a

first subcontractor and McCloskey the prime contractor, and plaintiff would have sufficient standing to recover under the bond even under the restrictive interpretation of *MacEvoy*.

The language used by Judge Watkins in *Ft. George G. Mcade* is particularly apposite to the problem before this court for, confronted with defendant's contention that the contractual arrangements control, he stated:

"The court is not only interested in, but obviously cannot decide the case without, factual information as to the actual relationship between Miller and McCloskey, for on the issue of whether or not the use-plaintiff stands in too remote a relationship to the prime contractor, the *problem before the court is, does substance or form control in determining who is the prime contractor*; that is, whether entitlement to relief is governed by the actual role and function of performance of a party, or is otherwise based on some formal criteria, as the term or the label by which a party may be designated in a contract.

*Substance controls.* In *MacEvoy Co. v. United States*, 1944, 322 U.S. 102, 64 S.Ct. 890, 88 L.Ed. 1163, the Supreme Court looked to the function performed by the plaintiff in relation to the prime contractor." (emphasis supplied).

And in *Continental Casualty Co. v. United States*, 308 F. 2d 846 (5th Cir. 1962), Hal Hayes Texas, Inc. was awarded the prime contract with the government to construct Capehart Act housing. It subcontracted with its subsidiary Winn Contractors, Inc. which in turn subcontracted a portion of the job with Mojave Elec-

tric. Mojave in turn contracted with the use plaintiff which supplied some creosoted utility poles for the job in question. In defense to the use plaintiff's suit on the Capehart Act bond, defendants argued that plaintiff was too far removed from either Hal Hayes Texas, Inc., or its first subcontractor, Winn Contractors, Inc., to recover on the bond. The trial court, however, allowed the jury to decide if Winn was a real subcontractor or only a sham or device or subterfuge and a mere tool of Hal Hayes Texas, Inc. when applied to the Capehart housing project contract in question. The jury decided for plaintiff and the Fifth Circuit affirmed, holding that it was proper to submit this matter to the jury since substance rather than form dictated the question of whether or not the use plaintiff had a sufficient connection to sue on the bond. Moreover, it noted that the evidence in the case made it clear that Winn in no way participated in the fulfillment of Hal Hayes Texas, Inc.'s contract with Mojave Electric.

See also: *Bushman Construction Co. v. Conner*, (10th Cir. 1962), 307 F. 2d 888, which, according to District Judge Oliver writing in the *Fine* case, "illustrates that paper relationships may be telescoped at points other than that between the prime contractor and one of his shadow subcontractors."

These authorities are certainly applicable to the instant case where Harris might not have been even a "paper contractor". [C. T. p. 169, line 12, to p. 170, line 2].

Appellants' sole argument in opposition to this wealth of authority seems to be that (a) on technical contract grounds there was not a total assignment of Harris' contract with Dixon and (b) under general definition



of the term “subcontractor” Yost herein was acting as a subcontractor. (See Opening Brief, pp. 11-20). But this twofold argument totally misses the mark because we are not dealing here with general principles of contract law but rather with the remedial Miller Act and the cases reviewed above clearly require a holding by this court that for Miller Act purposes one who, in fact, has not performed part of the contract on a work of public construction is not to be treated as a subcontractor thereunder, no matter what his paper relationship to the job may have been.

It is most interesting to note that appellants do not even attempt to distinguish the *Fine, Ft. George G. Meade*, and other cases reviewed above which are so clearly applicable herein, since, as appellants themselves admit:

(i) “Harris delegated all of his duties under the Dixon-Harris subcontract . . .” (Op. Br. p. 15, lines 23-24).

(ii) “. . . Yost performed all the physical labor under the Harris-Dixon subcontract (Op. Br. p. 16, third full paragraph, line 1); and,

(iii) “Dixon knew Harris was using a subcontractor without authorization but did not complain for well over a month.” (Op. Br. p. 26, lines 21-23).\*

Thus, under the authorities reviewed above and for Miller Act purposes it is respectfully submitted that

---

\*Appellants do not contend, and it is doubtful that as a matter of law, it is necessary to show that Dixon had such knowledge. Cf. *Glassell-Taylor Co. v. Magnolia Petroleum Co.*, 153 F. 2d 527, 530-31 (5th Cir. 1946); *United States v. Aetna Cas. & Surety Co.*, 56 F. Supp. 431, 434-35 (D. Conn. 1944).

the court must find Harris to be nothing more than a paper contractor who must be telescoped out of the chain, for the purpose of determining Paramount's right to sue on the subject bond.

### Conclusion.

The Supreme Court of the United States has often stated that the Miller Act "is highly remedial in nature. It is entitled to a liberal construction and application in order properly to effectuate the Congressional intent to protect those whose labor and materials go into public projects."

*Fleisher Engineering Co. v. United States*, 311 U.S. 15, 17, 18;

*United States v. Carter*, *supra*.

The Court has also stated:

"The Miller Act represents a Congressional effort to protect persons supplying labor and material for the construction of federal public buildings in lieu of the protection they might receive under the statutes with respect to the construction of non-federal buildings."

*United States v. Carter*, 353 U.S. at 216, 1 L. Ed 2d at 782.

In order to effectuate this policy and for all of the reasons set forth above, this honorable court should affirm the Judgment of the court below insofar as it awards recovery to Use Plaintiff Paramount under the Miller Act.

Appellant Dixon had within its own power the means to protect itself from the Judgment obtained by Paramount in this lawsuit. It had secured from Harris his

acceptance of Dixon's standard subcontract form [Pltf. Ex. 3] which specifically provides in Paragraph 11 thereof (see Statement of Case, Paragraph 4) that Harris would furnish a labor and material bond in favor of Dixon upon request. As noted in one case (*Triangle Electric Supply Co. v. Mojave Electric Co.* 234 F. Supp. 293, 307 at n. 14 (W.D. Mo. 1964)) the extracting of a payment bond by the prime contractor from his subcontractors has been one of the traditional ways for over half a century by which the prime contractor has protected himself against claims such as those asserted by Paramount in the instant case. Dixon, not having availed itself of the protection afforded to it under its own contract, is entitled to no sympathy herein. Paramount, on the other hand, as one of the class of persons protected by the Miller Act is clearly entitled to recover thereunder.

Respectfully submitted,

GREENBERG & GLUSKER,

By RICHARD H. FLOUM,

*Attorneys for Appellee Paramount  
Truck Rental, Inc.*



### **Certificate.**

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit and, that, in my opinion, the foregoing brief is in full compliance with these rules.

RICHARD H. FLOUM





No. 20122

IN THE

# United States Court of Appeals

FOR THE NINTH CIRCUIT

---

UNITED STATES, to the Use of A. F. YOST,

*Plaintiffs,*

*vs.*

L. E. DIXON COMPANY, *et al.*,

*Defendants.*

---

L. E. DIXON COMPANY, a corporation,

*Cross-Complainant,*

*vs.*

VAN HARRIS, an individual doing business as HARRIS & SONS, *et al.*,

*Cross-Defendants.*

---

UNITED STATES, to the Use of PARAMOUNT TRUCK RENTAL,  
INC.,

*Plaintiff,*

*vs.*

FIDELITY AND DEPOSIT COMPANY OF MARYLAND, *et al.*,

*Defendants.*

---

Reply Brief of Appellees, Fidelity and Deposit  
Company of Maryland and L. E. Dixon Company.

---

THELEN, MARRIN, JOHNSON & BRIDGES,

811 West Seventh Street,

Los Angeles, California,

*Attorneys for Appellees.*

**FILED**  
AUG 20 1965

FRANK H. SCHMID, CLERK



## TOPICAL INDEX

	Page
I.	
Jurisdictional statement .....	1
II.	
Argument .....	2
A. An award of attorneys' fees is neither provided for nor required by the Miller Act itself .....	2
B. Appellant is not entitled to attorneys' fees under state law .....	6
III.	
Conclusion .....	10

## TABLE OF AUTHORITIES CITED

Cases	Page
B. C. Richter Contracting Co. v. Continental Casualty Co., 230 A.C.A. 540, 41 Cal. Rptr. 98 ..	
.....	7, 9, 10
D & L Construction Co. v. Triangle Elec. Supply Co., 332 F. 2d 1009 .....	9
Illinois Security Co. v. John Davis Co., 244 U.S. 376, 61 L. Ed. 1206 .....	5
National State Bank of Newark v. Terminal Const. Corp., 217 F. Supp. 341 .....	9
Six Companies of California v. Joint Highway District No. 13, 311 U.S. 180, 85 L. Ed. 114 .....	10
United States v. Breeden, 110 F. Supp. 713 ....	2, 3, 4
United States v. Fidelity and Deposit Co. of Maryland, 144 F. Supp. 322 .....	2, 4, 5
United States v. Hoffman Construction Co., 163 F. Supp. 296 .....	2, 6
United States v. Reliance Ins. Co. of Philadelphia, Pa., 227 F. Supp. 939 .....	9
United States v. Travelers Ind. Co., 215 F. Supp. 455 .....	9



Statutes	Page
55-11-51 Alaska Compiled Laws, 1949 .....	3
55-11-52 Alaska Compiled Laws, 1949 .....	3
Code of Civil Procedure, Sec. 1021 .....	6, 7
Government Code, Sec. 4200 .....	7
Government Code, Sec. 4204 .....	7
Government Code, Sec. 4207 .....	7
49 Statutes at Large, p. 794 .....	1
73 Statutes at Large, p. 279 .....	1
United States Code, Title 40, Sec. 270(b) .....	1



No. 20122

IN THE

**United States Court of Appeals**

FOR THE NINTH CIRCUIT

---

UNITED STATES, to the Use of A. F. YOST,  
*Plaintiffs,*  
*vs.*  
L. E. DIXON COMPANY, *et al.*,  
*Defendants.*

---

L. E. DIXON COMPANY, a corporation,  
*Cross-Complainant,*  
*vs.*  
VAN HARRIS, an individual doing business as HARRIS & SONS, *et al.*,  
*Cross-Defendants.*

---

UNITED STATES, to the Use of PARAMOUNT TRUCK RENTAL,  
INC.,  
*Plaintiff,*  
*vs.*  
FIDELITY AND DEPOSIT COMPANY OF MARYLAND, *et al.*,  
*Defendants.*

---

Reply Brief of Appellees, Fidelity and Deposit  
Company of Maryland and L. E. Dixon Company.

---

I.

**JURISDICTIONAL STATEMENT.**

This is an appeal from the denial of attorneys' fees in an action brought under the Miller Act, 49 Stat. 794 (1935), 40 U.S.C. §270b (1952), as amended 73 Stat. 279 (1959), and this court's jurisdiction on appeal rests upon 65 Stat. 726, 28 U.S.C. §1291 (1951).

II.

ARGUMENT.

**A. An Award of Attorneys' Fees Is Neither Provided for nor Required by the Miller Act Itself.**

Paramount Truck Rental, Inc., the appellant herein, argues that the Miller Act itself dictates an award of attorneys' fees to a successful use plaintiff suing on a Miller Act bond. Appellant did not see fit to raise this argument in its brief before the District Court below [Clk. Tr. pp. 86-89], and the argument is raised on this appeal despite the fact that the Miller Act itself does not in any way deal with or even mention the question of attorneys' fees. And yet, "it is an elementary principal of law . . . that a reasonable attorney's fee cannot be allowed to a successful litigant unless it is provided for by contract, or by a controlling statute." *United States v. Hoffman Construction Co.*, 163 F. Supp. 296, 297 (E.D. Wash. S.D. 1958). How then, can appellant argue that the Miller Act itself dictates an award of attorneys' fees?

Appellant's entire argument on this point is based upon two cases, *United States v. Breeden*, 110 F. Supp. 713 (D.C. Alaska 1953) and *United States v. Fidelity and Deposit Co. of Maryland*, 144 F. Supp. 322 (W.D. La. 1956). Appellant contends that these cases "held" that the "Miller Act itself provides for and requires the award of attorneys' fees in behalf of a prevailing use plaintiff." (Appellant's Op. Br. p. 3.) Even the most cursory reading of these cases, however, reveals that they did not so hold, despite the broad language quoted by appellant.

The first point to be noted about *United States v. Breeden*, *supra*, 110 F. Supp. 713, is that Alaska, at the time of the *Breeden* decision, had not yet attained statehood, and was governed by acts of the United States Congress. Furthermore, the District Court for the District of Alaska, a territorial court created by Congress, had jurisdiction over both Federal and local controversies. The Alaska law at that time, as enacted by the United States Congress, provided in part as follows:

“§55-11-51. Compensation of attorneys. The measure and mode of compensation of attorneys shall be left to the agreement, expressed or implied, of the parties; but there may be allowed to the prevailing party in the judgment certain sums by way of indemnity for his attorney fees in maintaining the action or defense thereto, *which allowances are termed costs.*” 55-11-51 Alaska Compiled Laws, 1949 (Emphasis added).

“§55-11-52. Costs allowed of course to plaintiff. Costs are allowed, of course, to the plaintiff *upon a judgment in the district court* in his favor in the following cases:

. . .

“Fifth. In an action not hereinbefore specified, for the recovery of money or damages, when the plaintiff shall recover fifty dollars or more.” 55-11-52 Alaska Compiled Laws, 1949 (Emphasis Added).

Thus, the District Court was faced, in the *Breeden* case, with a statute passed by the United States Congress declaring that reasonable attorneys' fees could be recovered as “costs”, and another statute passed by the



United States Congress declaring, without reservation, that costs are allowed, of course, "upon a judgment in the district court," meaning the District Court for the District of Alaska. Faced with these statutes, the court could hardly have done otherwise than to allow the use plaintiff his attorneys' fees. That the Alaska statutes were, in fact, the basis of the court's decision is shown by the following statement by the court:

"In the Montana case cited above [*United States v. Seaboard Surety Co.*, 26 F. Supp. 681 (D. Mont. 1938)], the decision [disallowing attorneys' fees] rested upon the local statutes of Montana which apparently failed to make any provision for allowance of the attorneys' fees for the prevailing parties in suits brought in the State.

"In Alaska, not only does the local statute quoted above make such provision, but it is itself an act of the Congress of the United States, although of only local application, and there is nothing in the act which indicates that its provisions would not be applicable to suits brought on a contractor's bond such as we have before us here".

*United States v. Breeden*, *supra*, 110 F. Supp. at 715.

Nor does the *Fidelity and Deposit Co.* case, *supra*, 144 F. Supp. 322, stand for the broad proposition that the Miller Act dictates an award of attorneys' fees. In that case, in fact, the question of the recovery of attorneys' fees incurred in a Miller Act suit was not even raised. Prior to the Miller Act suit in question in that case, the defendant had filed suit in the state court seeking an injunction restraining the use plaintiff from

removing his equipment from the job site. The use plaintiff subsequently succeeded in getting the state court injunction dissolved, incurring attorneys' fees in the sum of \$1,750.00. Thereafter, in the Miller Act suit, the use plaintiff sought, and was awarded, reimbursement for the attorneys' fees *incurred in the state court action*. In reaching this decision, the court cited *Illinois Security Co. v. John Davis Co.*, 244 U.S. 376, 61 L. Ed. 1206 (1917), and noted: "Court allowed expenses of getting equipment to and from job site." *United States v. Fidelity and Deposit Co. of Maryland*, *supra*, 144 F. Supp. at 329. It is clear, therefore, that the award of attorneys' fees in that case was not based upon the court's belief that the Miller Act dictates the recovery of attorneys' fees in a Miller Act suit, since the fees awarded were not incurred in prosecuting the Miller Act suit; rather, the award was made merely to compensate the use plaintiff for all expenses in getting his equipment from the job site, which happened to include, in that case, attorneys' fees incurred in the state court action.

In summary, then, appellant has attempted to construct an argument overthrowing the well established rule against an award of attorneys' fees in the absence of a contractual or statutory provision specifically providing for their recovery, and in support of this argument has cited and relied exclusively upon two cases, neither of which, in fact, stands for the proposition attributed to it. Appellees respectfully submit that appellant has utterly failed to show any rational basis for the proposition that the Miller Act itself dictates an award of attorneys' fees to a use plaintiff.

## B. Appellant Is Not Entitled to Attorneys' Fees Under State Law.

Appellant makes the assumption that if the Miller Act itself does not require an award for attorneys' fees, then resort must be made to State law to determine the propriety of such an award. Although some courts have so held, appellees respectfully submit that the better reasoned rule is that set down in *United States v. Hoffman Construction Co.*, *supra*, 163 F. Supp. 296, 297, where the court stated:

“[T]he Miller Act is silent as to whether such allowances may be made. It is an elementary principal of law, however, that a reasonable attorney's fee cannot be allowed to a successful litigant unless it is provided for by contract, or by a controlling statute. I do not believe that the provisions of the statutes of the State of Washington respecting allowance of a reasonable attorney's fee in actions to foreclose liens for labor and materials can be carried over and incorporated into the Miller Act. The Miller Act is a different, separate statute which provides for a particular and peculiar type of action.”

Assuming, however, but in no way conceding, that state law should be applied in deciding the propriety of an award of attorneys' fees in a Miller Act suit, California law does not, either expressly or by public policy implication, allow such an award. The overriding statement of California policy in this regard is found in California Code of Civil Procedure, Section 1021, which provides in part:

“*Except as attorney's fees are specifically provided for by statute*, the measure and mode of

compensation of attorneys and counselors at law is left to the agreement . . . of the parties . . .” (Emphasis added).

Appellant, ignoring this crystal clear statement of California policy, contends that California policy is more clearly discernible by implication from Sections 4200, 4204 and 4207 of the California Government Code, which are nothing more than a narrow, statutory exception to the primary policy declared by Section 1021 of the Code of Civil Procedure.

It is strange that appellant would have devoted so much time and energy in attempting to convince this court that Government Code Sections 4200, 4204 and 4207 dictate an award of attorneys’ fees in this case, inasmuch as a California appellate court has recently rendered the question academic in *B. C. Richter Contracting Co. v. Continental Casualty Co.*, 230 A.C.A. 540, 41 Cal. Rptr. 98 (1964). There, the suit was brought on a Capehart Act bond, and the plaintiff made exactly the same “public policy” argument that appellant herein has made. Judge Friedman, speaking for a unanimous court, responded as follows:

“In actions at law in California, attorney fees are not recoverable in the absence of a contractual agreement or special statute. (*Reid v. Valley Restaurants, Inc.*, 48 Cal.2d 606, 610, 311 P.2d 473.) Since there was no contract for a fee, the award made by the trial court must find some statutory foundation. Government Code Section 4207, authorizing fee awards in suits on contractors’ bonds, applies only to public works of the State of California and of California political subdivisions and agencies. (Gov. Code §4200.) Section 4207 has

*no application to private construction projects or to projects of the United States.* It formulates a rule for a restricted class of projects, those undertaken by the State and its instrumentalities. The appeal briefs debate whether a Capehart Act project is “public” or ‘private.’ The debate is pointless, since—whatever it is—*the project is not one to which the California statute applies.* That statute is a false quantity, an irrelevant happenstance, in this lawsuit. California does not authorize award of an attorney fee against Hayes-Cal, the principal obligor; thus, there is no liability which may be passed on to the surety. *The trial court erred in awarding attorney fees.*

“At least one Miller Act decision has pursued state law to the point of awarding an attorney fee on the strength of a state statute like that of California, authorizing fee awards in suretyship actions on state public works contracts. (*United States for Use and Benefit of Western Steel Co. v. Reliance Ins. Co. of Philadelphia, Pa.*, 227 F. Supp. 939 (D.C. Mont., 1964).) [Relied heavily upon by appellant herein.] Such an award, we think, misses the point that the surety’s liability is an extension of its principal’s. The decision runs counter to the current of federal decisional law, which permits the award only where state law would have made the contractor himself liable for a fee.” 230 A.C.A. at 555, 41 Cal. Rptr. at 108 (Emphasis added).

A clearer exposition of California policy by a California court could not be hoped for than is contained in this rather long but extremely comprehensive quota-



tion. It meets head-on the very arguments put forth by appellant herein, even to the point of disapproving of and rejecting the reasoning of the court in *United States v. Reliance Ins. Co. of Philadelphia, Pa.*, *supra*, 227 F. Supp. 939, the very case upon which appellant relies most heavily. That the *Richter* case was a Capehart rather than a Miller Act suit is of no relevant concern, since it is a well established rule that Capehart and Miller Act decisions are, for most purposes, interchangeable.

“We find the protection accorded by the Miller and Capehart Acts is in many instances identical. Both are an attempt to protect the laborers and materialmen on a government project, where they have no rights under the state lien laws. To this extent the two acts should be interpreted together, and this court will do so except in those cases where the Miller Act, or the cases decided under it, are contradicted by the Capehart Act, the cases decided under it, or the terms of the bond.” *National State Bank of Newark v. Terminal Const. Corp.*, 217 F. Supp. 341, 351 (D.N.J. 1963). See also, *D & L Construction Co. v. Triangle Elec. Supply Co.*, 332 F.2d 1009 (8th Cir., 1964); *United States v. Travelers Ind. Co.*, 215 F. Supp. 455 (W.D. Mo. 1963); *B. C. Richter Contracting Co. v. Continental Casualty Co.*, *supra*, 41 Cal.Rptr. 98, 103.

It has been directly held by the United States Supreme Court that where, as here in the *Richter* case, *supra*, an intermediate state appellate court has announced the state law on a given issue, the Federal courts are bound by that decision unless there is con-

vincing evidence that the law of the State is otherwise. *Six Companies of California v. Joint Highway District No. 13*, 311 U.S. 180, 85 L. Ed. 114 (1940). Appellees respectfully submit, therefore, that even assuming, *arguendo*, that state law does control the award of attorneys' fees under the Miller Act, the *Richter* decision, *supra*, conclusively prohibits such an award under California law.

### III.

#### Conclusion.

The court below did not err in denying appellant an award for attorneys' fees, since neither the Miller Act itself nor the law of California provides for such an award.

THELEN, MARRIN, JOHNSON &  
BRIDGES,  
JAMES W. BALDWIN,  
ROBERT K. WORRELL,  
ANDREW J. NOCAS,

*Attorneys for Appellees, Fidelity and  
Deposit Company of Maryland and  
L. E. Dixon Company.*

### **Certificate.**

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit and that, in my opinion, the foregoing brief is in full compliance with those rules.

JAMES W. BALDWIN



# United States Court of Appeals

FOR THE NINTH CIRCUIT

---

FIDELITY AND DEPOSIT COMPANY OF MARYLAND  
and L. E. DIXON COMPANY,

*Appellants,*

*vs.*

VAN HARRIS, an individual, doing business as Harris & Sons,  
*Appellee.*

---

FIDELITY AND DEPOSIT COMPANY OF MARYLAND  
and L. E. DIXON COMPANY,

*Appellants,*

*vs.*

PARAMOUNT TRUCK RENTAL, INC., and VAN HARRIS,  
an individual doing business as Harris & Sons,

*Appellees.*

---

PARAMOUNT TRUCK RENTAL, INC.,

*Appellant,*

*vs.*

FIDELITY AND DEPOSIT COMPANY OF MARYLAND  
and L. E. DIXON COMPANY,

*Appellees.*

---

On Appeal From the United States District Court for the  
Southern District of California, Central Division.

---

Brief of Appellants L. E. Dixon Company and  
Fidelity and Deposit Company of Maryland.

---

THELEN, MARRIN, JOHNSON &  
BRIDGES,

JAMES W. BALDWIN,

ROBERT K. WORRELL,

ANDREW J. NOCAS,

811 West Seventh Street,  
Los Angeles, Calif. 90017,

*Attorneys for Appellants L. E. Dixon  
Company and Fidelity and Deposit  
Company of Maryland.*

FILED

JUL 23 1965

FRANK H. SCHIND, CLERK





## TOPICAL INDEX

	Page
Jurisdictional statement .....	1
Statement of the case .....	2
Statutes involved .....	5
Bonds of contractors for public buildings or works; waiver of bonds covering contract performed in foreign country .....	5
Same; rights of persons furnishing labor or mate- rial .....	6
Specifications of error .....	8
Summary of argument .....	9
Argument .....	11

### I.

Paramount is too far removed from the general contractor to be within the protection of the Miller Act bond .....	11
---	----

### II.

Dixon was not the "contractor" within the meaning of the Miller Act .....	21
--	----

### III.

Proof of a promise by Dixon to indemnify Paramount for the cost of materials and la- bor which Yost would not pay for is barred by the California Statute of Frauds .....	23
--	----

### IV.

The District Court erred in holding that there was no written contract between Harris and Dixon .....	24
---	----

V.

The District Court erred in finding that Dixon prevented performance by Harris by insisting upon labor and material releases .....	27
--	----

VI.

The District Court erred in finding that Dixon breached the written subcontract .....	31
Conclusion .....	32

Table of Exhibits

Plaintiff Paramount's Exhibits .....	1
Defendant Dixon's Exhibits .....	2
Third Party Defendant Harris' Exhibits .....	2

## TABLE OF AUTHORITIES CITED

Cases	Page
Adams Mfg. and Eng. Co. v. Coast Centerless Grinding Co., 184 Cal. App. 2d 649, 7 Cal. Rptr. 761 .....	20
Aetna Insurance Co. v. Southern Waldrup & Harvick, 198 F. Supp. 505 .....	13
Arcweld Mfg. Co. v. Burney, 12 Wash. 2d 212, 121 P. 2d 350 .....	17, 18, 20, 22
Barkhaus v. Producers' Fruit Company, 192 Cal. 200, 219 Pac. 435 .....	14
Beatty v. Oakland Sheetmetal Supply Co., 111 Cal. App. 2d 53, 244 P. 2d 25 .....	25, 26
Brygiduir v. Rieman, 107 A. 2d 59 .....	17
Clay v. Walton, 9 Cal. 328 .....	24
E. E. Elmer v. United States Fidelity and Guarantee Co., 275 F. 2d 89 .....	13
Fidelity & Casualty Co. v. Fresno Flume & Irrigation Co., 161 Cal. 466, 119 Pac. 646 .....	26
Gray v. Cotton, 166 Cal. 130, 134 Pac. 1145 .....	28
Gregers v. Peterson Ice Cream Company, 158 Cal. App. 2d 746, 323 P. 2d 572 .....	15
Hayward's v. Nelson, 143 Cal. App. 2d 807, 299 P. 2d 1013 .....	20
Hihn-Hammond Lumber Co. v. Elsom, 171 Cal. 570, 154 Pac. 12 .....	17
Holbrook v. Fazio, 84 Cal. App. 2d 700, 191 P. 2d 123 .....	29
MacEvoy v. United States for the use and Benefit of Calvin Thompkins Company, 322 U.S. 102, 64 S. Ct. 890, 88 L. Ed. 1163 .....	9, 12, 13, 16, 20, 22
McCullough v. Krammerer Corp., 166 F. 2d 759, cert. den. 335 U.S. 813 .....	20, 21

Powers Regulator Company v. Seaboard Company of New York, 204 Cal. App. 2d 338, 22 Cal. Rptr. 373 .....	14, 16
Smith v. Wilcox, 44 Ore. 323, 74 Pac. 708, sub. op. 44 Ore. 323, 75 Pac. 710 .....	18, 22
Smoll v. Webb, 55 Cal. App. 2d 456, 130 P. 2d 773 .....	27
Staley v. New, 250 P. 2d 893 .....	17
Trottier v. M. H. Golden Construction Company, 105 Cal. App. 2d 511, 233 P. 2d 675 .....	29
Trubowitch v. Riverbank Canning Co., 30 Cal. 2d 335, 182 P. 2d 182 .....	25
United States for use and Benefit of Jonathan Handy Co. Inc. v. Deschenes Construction Co., Inc., 188 F. Supp. 270 .....	13
United States for use and Benefit of Newport News Shipbuilding & Dry Dock Co. v. Blount Bros. Construction Co., 168 F. Supp. 407 .....	13
United States for the Use of West Pacific Sales Co., Inc. v. Harder Industrial Contractors, Inc., 225 F. Supp. 699 .....	22
United States for the use and Benefit of Whit- more Oxygen Co. v. Idaho Crane & Rigging Co., 193 F. Supp. 802 .....	13

#### Statutes

Civil Code, Sec. 1624 .....	8
Civil Code, Sec. 1624(2) .....	24
Miller Act, Sec. 1 .....	3, 5, 11
Miller Act, Sec. 2 .....	2, 6, 11
Public Law 80-135, Sec. 1 .....	2, 6
49 Statutes at Large (1935), p. 793 .....	3, 5, 11
49 Statutes at Large (1935), p. 794 .....	2, 6, 11
56 Statutes at Large (1942), p. 245 .....	18
60 Statutes at Large (1946), p. 38 .....	18



	Page
65 Statutes at Large (1951), p. 8 .....	18
73 Statutes at Large, p. 279 .....	2, 6, 11
United States Code, Title 40, Sec. 270(a) .....	3, 5, 11
United States Code, Title 40, Sec. 270(b) ....	2, 6, 11, 12
United States Code, Title 41, Sec. 52 .....	18
United States Code Appendix, Title 50, Sec. 1191-	
(5)A .....	18
United States Code Appendix, Title 50, Sec. 1213-	
(g) .....	18

### Textbooks

12 California Jurisprudence 2d, Sec. 123 .....	28
23 California Jurisprudence 2d, Sec. 89 .....	24
28 California Jurisprudence 2d, Sec. 3 .....	21
4 Corbin, Contracts (1951), Sec. 864 .....	15
4 Corbin, Contracts (1951), Sec. 866 .....	15
Cyclopedic Law Dictionary (3rd Ed. 1940) .....	17
3 Williston, Contracts (3rd ed. 1961), Sec. 407 ....	15
3 Williston, Contracts (3rd Ed. 1961), Sec. 411 ....	15



No. 20121, 20122

IN THE

# United States Court of Appeals

FOR THE NINTH CIRCUIT

---

FIDELITY AND DEPOSIT COMPANY OF MARYLAND  
and L. E. DIXON COMPANY,

*Appellants,*

*vs.*

VAN HARRIS, an individual, doing business as Harris & Sons,

*Appellee.*

---

FIDELITY AND DEPOSIT COMPANY OF MARYLAND  
and L. E. DIXON COMPANY,

*Appellants,*

*vs.*

PARAMOUNT TRUCK RENTAL, INC., and VAN HARRIS,  
an individual doing business as Harris & Sons,

*Appellees.*

---

PARAMOUNT TRUCK RENTAL, INC.,

*Appellant,*

*vs.*

FIDELITY AND DEPOSIT COMPANY OF MARYLAND  
and L. E. DIXON COMPANY,

*Appellees.*

---

On Appeal From the United States District Court for the  
Southern District of California, Central Division.

---

Brief of Appellants L. E. Dixon Company and  
Fidelity and Deposit Company of Maryland.

---

## Jurisdictional Statement.

This is an appeal from judgments entered in two consolidated cases on March 23, 1965, by the United States

District Court for the Southern District of California, Central Division [C. T. p. 177].

Both plaintiffs based jurisdiction of the District Court on Section 2 of the Miller Act, 49 Stat. 794 (1935), 40 U.S.C. §270b (1952), as amended August 9, 1959, Pub. L. 80-135, §1, 73 Stat. 279 [C. T. pp. 2 and 147]. Appellants L. E. Dixon Company and Fidelity and Deposit Company of Maryland filed a timely notice on appeal [C. T. p. 184] and this Court's jurisdiction accordingly rests upon 28 U.S.C. §1291.

### **Statement of the Case.**

Prior to June 18, 1962, the California Institute of Technology (hereinafter referred to as "Cal Tech") contracted with the United States Government to do certain development work [Pltf. Ex. 1, hereinafter referred to as the "Prime Contract"]. Subsection (b) of Article I of the Prime Contract provides that:

"The Contractor may, when authorized by Task Orders or Task Order Amendments, enter into subcontracts for the construction of facilities by approved Construction of Facilities Projects."

Article 6 of the Prime Contract, entitled "SUBCONTRACTS", specifies the terms by which Cal Tech could subcontract the construction work necessary to fulfill the obligations of the Prime Contract.

On June 18, 1962, pursuant to a Task Order issued under the Prime Contract, Cal Tech entered into a subcontract with defendant and appellant L. E. Dixon Company (hereinafter referred to as "Dixon"), by the terms of which Dixon agreed to construct the Central Engineering Building at the Jet Propulsion Laboratory in

Pasadena, California [Pltf. Exs. 7 and 8]. Defendant Fidelity and Deposit Company of Maryland (hereinafter referred to as "Fidelity"), as surety, executed a bond pursuant to Section 1 of the Miller Act, 49 Stat. 793 (1935), 40 U.S.C. 270a [Pltf. Ex. 2].

Having taken subcontract bids for portions of the work to be performed by it, Dixon, on or about June 21, 1962, received by mail a written subcontract [Pltf. Ex. 3] executed by cross-defendant Van Harris, an individual doing business as Harris & Sons (hereinafter referred to as "Harris"), accompanied by a letter of transmittal [Pltf. Ex. 5]. By the terms of said subcontract, Harris agreed to perform certain grading and excavation operations in connection with the construction of the Central Engineering Building.

Shortly thereafter, Harris entered into an agreement with use plaintiff Andrew Franklin Yost (hereinafter referred to as "Yost"), whereby Yost agreed to perform all of the physical work which Harris had agreed to perform for Dixon [Pltf. Ex. 4]. Yost then entered into an agreement with use plaintiff Paramount Truck Rental, Inc., (hereinafter referred to as "Paramount"), whereby Paramount agreed to furnish to Yost on a rental basis certain labor and equipment necessary for the excavation and grading at the Central Engineering Building site [R.T., Vol. I, page 54, lines 3-8].

The work was commenced on July 1, 1962, by Yost and Paramount with Harris supervising. On July 20, Harris submitted a bill for \$7,213.50 to Dixon to cover the completion of the first third of the work. This first progress payment was paid by Dixon around August 10, 1962 [R.T., Vol. II, p. 227, lines 8-23]. The second progress payment covering the next twenty percent of

the work was never made due to the inability of Harris to provide labor and material releases from Paramount and Yost [Pltf. Ex. 9]. Thereafter, Yost and Paramount ceased all work on the project [R.T., Vol. II, p. 185, lines 16-23; p. 196, lines 9-12], except for some work performed at the request of Dixon. Dixon paid for part of this work, and it is not involved herein [R.T. Vol. I, p. 135, line 25, to p. 136, line 11]. Paramount contends that services of the value of \$431.09 were performed by it directly at the request of Dixon and this amount is in dispute herein [R.T., Vol. I, p. 65, line 10, to p. 68, line 3; C.T., p. 173, lines 29-30]. Dixon was required to spend \$43,037.70 in order to complete the grading and excavation [R.T., Vol. II, p. 231, lines 12-17].

The present action is a consolidation of separate suits brought by use plaintiffs Yost and Paramount against appellants Dixon and Fidelity. Both plaintiffs sought recovery under the bond executed by Dixon and Fidelity. Cal Tech and the United States are named as joint obligees on that bond and Dixon is named as the principal. In the Paramount action, Dixon filed and served a third party complaint against Harris and Yost, and in the Yost action Dixon filed a cross-complaint against Harris and a counterclaim against Yost. The action brought by Yost was dismissed prior to trial [C. T., p. 141], and hence Yost is not involved in this appeal. The trial court gave judgment for appellee Paramount in its action against appellants Dixon and Fidelity and gave judgment for appellee Harris in the cross actions brought by appellant Dixon [C. T., p. 177]. Appellants Dixon and Fidelity appeal from such judgments [C. T., p. 184].



## Statutes Involved.

The Miller Act:

Section 1 [49 Stat. 793 (1935); 40 U.S.C. §270a].

### **Bonds of Contracters for Public Buildings or Works; Waiver of Bonds Covering Contract Performed in Foreign Country.**

(a) Before any contract, exceeding \$2,000 in amount, for the construction, alteration, or repair of any public building or public work of the United States is awarded to any person, such person shall furnish to the United States the following bonds, which shall become binding upon the award of the contract to such person, who is hereinafter designated as "contractor":

(1) A performance bond with a surety or sureties satisfactory to the officer awarding such contract, and in such amount as he shall deem adequate, for the protection of the United States.

(2) A payment bond with a surety or sureties satisfactory to such officer for the protection of all persons supplying labor and material in the prosecution of the work provided for in said contract for the use of each such person. Whenever the total amount payable by the terms of the contract shall be not more than \$1,000,000 the said payment bond shall be in a sum of one-half the total amount payable by the terms of the contract. Whenever the total amount payable by the terms of the contract shall be more than \$1,000,000 and not more than \$5,000,000, the said payment bond shall be in a sum on 40 per centum of the total amount payable by the terms of the contract. Whenever the

total amount payable by the terms of the contract shall be more than \$5,000,000 the said payment bond shall be in the sum of \$2,500,000.

(b) The contracting officer in respect of any contract is authorized to waive the requirement of a performance bond and payment bond for so much on the work under such contract as is to be performed in a foreign country if he finds that it is impracticable for the contractor to furnish such bonds.

(c) Nothing in this section shall be construed to limit the authority of any contracting officer to require a performance bond or other security in addition to those, or in cases other than the cases specified in subsection (a) of this section.

Section 2 [49 Stat. 794 (1935); 40 U.S.C. §270b, as amended August 4, 1959, Pub. L. 86-175, §1, 73 Stat. 279]:

**Same; Rights of Persons Furnishing  
Labor or Material.**

(a) Every person who has furnished labor or material in the prosecution of the work provided for in such contract, in respect of which a payment bond is furnished under Section 270a of this title and who has not been paid in full therefor before the expiration of a period of ninety days after the day on which the last of the labor was done or performed by him or material was furnished or supplied by him for which such claim is made, shall have the right to sue on such payment

bond for the amount, or the balance thereof, unpaid at the time of institution of such suit and to prosecute said action to final execution and judgment for the sum or sums justly due him: *Provided, however,* That any person having direct contractual relationship with a subcontractor but no contractual relationship, express or implied, with the contractor furnishing said payment bond shall have a right of action upon the said payment bond upon giving written notice to said contractor within ninety days from the date on which such person did or performed the last of the labor furnished or supplied the last of the material for which such claim is made, stating with substantial accuracy the amount claimed and the name of the party to whom the material was furnished or supplied or for whom the labor was done or performed. Such notice shall be served by mailing the same by registered mail, postage prepaid, in an envelope addressed to the contractor at any place he maintains an office or conducts his business, or his residence, or in any manner in which the United States marshal of the district in which the public improvement is situated is authorized by law to serve summons.

(b) Every suit instituted under this section shall be brought in the name of the United States for the use of the person suing, in the United States District Court for any district in which the contract was to be performed and executed and not elsewhere, irrespective of the amount in controversy in such suit, but no such

suit shall be commenced after the expiration of one year after the day on which the last of the labor was performed or material was supplied by him. The United States shall not be liable for the payment of any costs or expenses of any such suit.

California Civil Code, §1624. *Statute of Frauds.*

The following contracts are invalid, unless the same, or some note or memorandum thereof, is in writing and subscribed by the party to be charged or by his agent: . . .

2. A special promise to answer for the debt, default, or miscarriage of another; except in the cases provided for in Section 2794; . . .

### **Specifications of Error.**

(1) The District Court erred in finding that Paramount was a subcontractor of, or joint-venturer with, a subcontractor of Dixon;

(2) The District Court erred in finding that Dixon was the "contractor" within the meaning of the Miller Act;

(3) The District Court erred in finding that Paramount was within the protection on the bond in question;

(4) The District Court erred in finding that there was no valid written contract between Dixon and Harris;

(5) The District Court erred in finding that Dixon prevented performance of such written contract by Harris; and

(6) The District Court erred in finding that Dixon breached such written contract; and

(7) The District Court erred in denying Dixon recovery against Harris.

### Summary of Argument.

This action is brought by Paramount to recover against Dixon and its surety (Fidelity) on a bond executed by them under the provisions of the Miller Act. Under the rule announced in *MacEvoy v. United States for the use and Benefit of Calvin Thompkins Company*, 322 U.S. 102, 64 S.C. 890, 88 L. ed. 1163 (1944), only suppliers or subcontractors to the prime contractor or to a subcontractor of the prime contractor may recover on such bonds; *i.e.*, suppliers on the fourth "tier" or below cannot recover. In the instant action Cal Tech contracted to build an engineering building for the United States. Thereafter Dixon contracted with Cal Tech to do the construction work and Harris contracted with Dixon to do the grading and excavation. Harris in turn contracted with Yost, whereby Yost agreed to do all of the grading and excavation. Paramount rented equipment and labor to Yost. Paramount, therefore, was on the fourth "tier" from Dixon and on the fifth "tier" from Cal Tech. On these facts, the District Court held that Dixon was actually the prime contractor and that Harris, by reason of the delegation of all of his duties to Yost, was thus removed from the chain of subcontractors and that Paramount, therefore, was entitled to recover on the bond.

Appellants respectfully submit that such findings are contrary to law, in that Harris was at all times a subcontractor and Dixon was not the general contractor.

Midway through the work, Harris ceased performance of the grading and excavation which he had contracted to perform. As a result, Dixon incurred \$43,037.70 in expenses in completing the work. Dixon's action against Harris seeks reimbursement of this amount as well as any amounts Dixon might be required to pay Paramount. The District Court found that there was no written contract between Dixon and Harris, but only an implied contract for value of services rendered. The District Court further found that Dixon prevented Harris' performance of any contract by conditioning progress payments on Harris' providing releases from Yost and Paramount and that Dixon had breached any express contract by improperly engineering the work and by refusing to allow Harris to stockpile reusable dirt on the job site. Appellants respectfully submit that such findings are unsupported by evidence and are contrary to law.



## ARGUMENT.

### I.

#### **Paramount Is Too Far Removed From the General Contractor to Be Within the Protection of the Miller Act Bond.**

Section 1 of the Miller Act, 49 Stat. 793 (1935), 40 U.S.C. §270a, provides for the posting of a payment bond with the United States before any contract exceeding \$2,000.00 in amount is awarded for the construction, alteration, or repair of any public building or public work of the United States. Section 2 of the Miller Act, 49 Stat. 794 (1935), 40 U.S.C. §270b, as amended by 73 Stat. 279 (1959), which deals with the rights of persons furnishing labor or materials under such a bond, provides as follows:

“(a) Every person who has furnished labor or material in the prosecution of the work provided for in such contract, in respect of which a payment bond is furnished under §270a of this title and who has not been paid in full therefor before the expiration of a period of ninety days after the day on which the last of the labor was done or performed by him or material was furnished or supplied by him for which such claim is made, shall have the right to sue on such payment bond for the amount, or the balance thereof, unpaid at the time of institution of such suit and to prosecute said action to final execution and judgment for the sum or sums justly due him; *Provided, however,* That any person having direct contractual relationship with a subcontractor but no contractual relationship express or implied with the contractor furnishing said payment bond shall have

a right of action upon the said payment bond upon giving written notice to said contractor within ninety days from the date on which such person did or performed the last of the labor or furnished or supplied the last of the material for which such claim is made, stating with substantial accuracy the amount claimed and the name of the party to whom the material was furnished or supplied or for whom the labor was done or performed.”

The Supreme Court of the United States, in *Clifford F. MacEvoy Company v. United States for the use and Benefit of Calvin Thompkins Company*, 322 U.S. 102, 64 S.Ct. 890, 88 L. ed. 1163 (1944), had occasion to determine the scope of protection provided in this section of the Miller Act. In so doing, the Court held that:

“ . . . the right to bring suit on a payment bond is limited to (1) those materialmen, laborers and subcontractors *who deal directly with the prime contractor* and (2) those materialmen, laborers and sub-subcontractors who, lacking express or implied contractual relationship with the prime contractor, *have direct contractual relationship with the sub-contractor* and who gave the statutory notice of their claims to the prime contractor.” *Id.* at 107-108. (Emphasis added).

Since the decision in *MacEvoy*, the Federal Courts have consistently held that, in order for a materialman, laborer or subcontractor to bring himself within the protection of §270b, he must either be in privity of contract with the prime contractor, thereby making him a subcontractor, or in privity of contract with a subcontractor, thereby making him a sub-subcontractor.

Any materialman, laborer or subcontractor who falls below the third tier, *i.e.*, is not at least a sub-subcontractor, falls outside the protection of the Miller Act. *E. E. Elmer v. United States Fidelity and Guarantee Co.*, 275 F.2d 89 (5 Cir. 1960); *Aetna Insurance Co. v. Southern, Waldrup & Harwick*, 198 F. Supp. 505 (N.D. Cal. 1961); *United States for the use and Benefit of Whitmore Oxygen Co. v. Idaho Crane & Rigging Co.*, 193 F. Supp. 802 (E.D. Idaho 1961); *United States for use and Benefit of Jonathan Handy Co., Inc. v. Deschenes Construction Co., Inc.*, 188 F. Supp. 270 (D.Mass. 1960); *United States for use and Benefit of Newport News Shipbuilding & Dry Dock Co. v. Blount Bros. Construction Co.*, 168 F. Supp. 407 (D. Md. 1959).

Under the rule announced in *MacEvoy*, Paramount, in order to recover under the bond, must show that Dixon was a prime contractor and that Paramount was in privity of contract with either Dixon or a subcontractor of Dixon. In this action, the trial court held that Dixon was the "General Contractor" under the Miller Act [C. T., pp. 164-165, 175-176] and further held that Paramount was not precluded from recovery by reason of the *MacEvoy* rule since Dixon's subcontractor (Harris) had delegated all of the burdens of his contract to Yost, thereby making Yost a subcontractor of Dixon and Paramount a supplier of materials to a subcontractor of Dixon (Yost) and therefore within the protection of the Miller Act [C. T., pp. 162, 165-168; and in particular p. 167, lines 14-22].

The trial court apparently agreed with Paramount's theory that Yost, who supplied all the physical labor, was a subcontractor of Dixon and Harris was only a

“paper subcontractor.” The record shows, however, that Harris was a subcontractor with real duties and rights; his subcontract was not simply a paper transaction devised by Dixon to avoid liability. There was no novation; Dixon always looked to Harris for performance and Yost looked to Harris for payment. Further, Harris participated in the performance of the contract [R. T., Vol. I, p. 44, lines 13-17, 23-25]. The weakness of Paramount’s theory is that, to the extent that any work on a construction project is subcontracted, the contractor becomes, to that extent, a “paper contractor.” According to that theory, an entirely different result would be reached if Harris had retained a small part of the physical work to perform himself. Paramount’s theory is an attempt to analogize to the distinction in real property law between a partial assignment of a lease (*i.e.*, a sublease) and a full assignment of a lease. See: *Barkhaus v. Producers’ Fruit Company*, 192 Cal. 200, 205-206, 219 Pac. 435, 437 (1923). Under real property law, a sublessee of the entire term of a lease is considered an assignee and has direct rights against the landlord. The explanation for this result is that the parties’ interests in the land constitute “estates”, which give rise to a “privity” between the sublessee and the landlord. *Barkhaus, supra*. In the instant situation, however, there is no “estate” or “privity” between a sub-subcontractor and the prime contractor of a construction contract and hence the sub-subcontractor has no rights against the prime contractor. *Powers Regulator Company v. Seaboard Company of New York*, 204 Cal. App. 2d 338, 345-346, 22 Cal. Rptr. 373, 377-378 (1962).

The contract between Dixon and Harris imposed certain duties upon Harris and granted him certain

rights. It is technically inaccurate to talk about Harris "assigning" his contract with Dixon since only rights are assignable; duties are delegable. Williston states:

"DISTINCTION BETWEEN ASSIGNMENT OF RIGHTS AND DELEGATION OF DUTIES. A clear conception of the law governing assignment of contracts can be obtained only by sharply distinguishing between . . . assignments of rights and of duties." [3 Williston, Contracts, §407, (3rd ed. 1961)]

"Section 411. DELEGATION OF DUTIES. The duties under a contract are not assignable *inter vivos* in a true sense under any circumstances; . . . .

"One who is subject to a duty though he cannot escape his obligation may delegate performance of it provided the duty does not require personal performance." [*Id.* §411].

See also: 4 Corbin, Contracts, §§864, 866 (1951); *Gregers v. Peterson Ice Cream Company*, 158 Cal. App. 2d 746, 323 P. 2d 572 (1958). Harris delegated all of his duties under the Dixon-Harris subcontract but there is no evidence in the record that he assigned any of his rights under that subcontract. The trial court found that:

"Yost was a partial assignee of Harris. An assignment depends upon substance rather than form. [Citation omitted.] Here, Yost was assigned all of Harris' burdens and had an equitable right to part of the payments due Harris from Dixon." [C. T. p. 167, lines 14-19].

Yost was to be paid a lower price by Harris than that paid by Dixon to Harris [Pltf. Exs. 3 and 4], and Yost could not, and did not, seek payment directly from Dixon. (After Harris abandoned the contract, Yost performed some work directly for Dixon. That work has been paid for and is not involved in this case [R. T., Vol. I, p. 135, line 25; p. 136, line 11]. Clearly, no attempt was made to assign Harris' rights under the Dixon-Harris subcontract to Yost. Every subcontract must, by its very nature, be an assignment (or, more accurately, a delegation) of burdens and the Harris-Yost agreement was just such a subcontract delegating all of Harris' duties to Yost. Harris' rights were not assigned. To follow the trial court's reasoning would be to abolish the *MacEvoy* rule altogether, since every subcontract must be an "assignment" or delegation of burdens.

If the Harris-Dixon contract had been "assigned," to Yost, then Yost would have had directed rights against and duties toward Dixon and if Dixon had breached its obligations, then Yost could have sued Dixon but not Harris. However, under the subcontract Yost had no rights against, or duties toward, Dixon and if Dixon breached its contract and hence affected Yost's rights, then Yost's only remedy would be against Harris, and not Dixon. *Powers Regulator Company, supra*.

The fact that Yost performed all the physical labor under the Harris-Dixon subcontract did not place him in privity of contract with Dixon since a subcontractor is one who does *part or all* of the work of the contractor. This definition has been affirmed by a number of authorities:

"Literally, a 'subcontractor' is one who agrees with another to perform *a part or all* of the obliga-



tions which the second party owes by contract to a third party.” (Emphasis added.) (*Hihn-Hammond Lumber Co. v. Elsom*, 171 Cal. 570, 154 Pac. 12, 14 (1915).)

“A subcontractor is one who contracts with a principal contractor to perform *all or part* of the work or services which the principal contractor has already contracted to perform.” (Emphasis added.) (*Arcweld Mfg. Co. v. Burney*, 12 Wash. 2d 212, 121 P. 2d 350, 353 (1942).)

“A subcontractor is one who enters into a contract with a person for the performance of work which such person has already contracted with another to perform. In other words, subcontracting is merely ‘farming out’ to others *all or part* of work contracted to be performed by the original contractor.” (Emphasis added.) (*Brygiduir v. Ricman*, 107 Atl. 2d 59, 60 (N. J. 1954).)

“A subcontractor may be briefly described as one who has entered into a contract, express or implied, for the performance of an act, with a person who has already contracted for its performance. . . .” (*Staley v. New*, 250 P.2d 893, 895 (N. M. 1952).)

“SUBCONTRACT. A contract by one who has contracted for the performance of labor or service with a third party for the *whole or part performance* of that labor or service.” (Emphasis added.) *Cyclopedic Law Dictionary* (3rd Ed. 1940).

“The term ‘subcontract’ therefore is not inappropriate to designate one who has contracted with the principal contractor to perform the whole as well as a part of the service which the latter

has undertaken to perform.” (*Smith v. Wilcox*, 44 Ore. 323, 74 Pac. 708 (1903), subsequent opinion at 44 Ore. 323, 75 Pac. 710 (1904).)

A number of federal statutes have employed a similar definition. Thus, 60 Stat. 38 (1946), 41 U.S.C. §52, defines a subcontractor as:

“ . . . [A]ny person, including a corporation, partnership, or business association of any kind, who holds an agreement or purchase order to perform *all or any part* of the work or to make or to furnish any article or service required for the performance of a cost-plus-a-fixed-fee or cost reimbursable contract or of a subcontract entered into thereunder. . . .” (Emphasis added.)

See also: 56 Stat. 245 (1942); 50 U.S.C. App. §1191 (5)A; 65 Stat. 8 (1951); 50 U.S.C. App. §1213(g). From the foregoing cases and commentaries, it is apparent that a contract to perform all the work for which another has contracted to perform is a subcontract, and not an assignment. The distinguishing features are that in an assignment the assignee receives *all* of the *rights* of the assignor and can enforce them directly against the obligor, while in a subcontract the subcontractor undertakes *duties* from the contractor; the subcontractor has rights against his contractor, but not against his contractor's contractor. The subcontractor's rights against the contractor generally, although not necessarily, are different from those of the contractor against the obligor. If a principal obligor breaches his duty, an assignee has direct rights against him, while a subcontractor would have no rights against the owner but would have rights against the contractor. This distinction is illustrated in *Arcweld Mfg. Co. v. Burney*, 12 Wash. 2d 212, 121 P.

2d 350 (1942). Burney contracted to perform some alterations and repairs on a home owned by the Home Owners' Loan Corporation (HOLC). Burney then contracted with Schonbein for the latter to do all the work. The court held that:

“Burney’s relation to HOLC with reference to the contract, however, was not changed by the subletting agreement; he still remained obligated to HOLC for the performance of the contract, and, likewise, was still entitled to look to HOLC for the compensation due thereunder. On the other hand, appellant did not, by his agreement with Burney, supplant the latter in his relation to HOLC, nor did he create any legal relation between himself and HOLC so far as the original contract was concerned. However great a personal interest appellant may have had in performing the work under the subletting agreement, he had no legal interest in Burney’s contract with HOLC. Appellant’s relation to Burney and HOLC comes squarely within the definition of ‘subcontractor’ just given. Burney was the principal contractor, having agreed to perform certain work; HOLC was the party with which that contract had been made and which, accordingly, was entitled to retain its relation with Burney; and appellant was a party contracting with the principal contractor to perform the work which the latter had previously contracted with another to perform. If Burney and appellant had intended to effect an *assignment* of the original contract, it would have been a simple matter, as well as the natural thing, to do so by the use of plain, unambiguous language.” (121 P.2d at p. 354.)

It should be noted that in *Arcweld* the prime contractor, Burney, assigned his rights to the funds from HOLC to Schonbein, a factor not presented in the instant case. The situation in this action also involves a subcontract (actually a sub-subcontract) since Yost did not, and could not, look to Dixon for payment [R. T., Vol. I, p. 44, lines 13-19]. The District Court's holding that a delegation of burdens avoids the *MacEvoy* rule has the effect of abolishing that rule altogether since every subcontract must be an "assignment" of burdens.

The District Court also mentioned the possibility that Yost and Paramount were "joint venturers" [C. T., p. 167, lines 19-22]. It is respectfully submitted that there is no indication anywhere in the record that such a joint venture agreement existed. At the trial herein, Robert Dick, general manager of Paramount, testified that Paramount and Yost did not enter into a joint venture agreement [R. T., Vol. I, p. 52, lines 7-10]; that Yost and Paramount did not share profits [R. T., Vol. I, p. 52, line 23, to p. 53, line 3]; and that Paramount was to be paid on a rental basis [R. T., Vol. I, p. 54, lines 3-8]. This testimony was corroborated by Yost [R. T., Vol. I, p. 105, line 18, to p. 106, line 5]. Clearly there was no joint venture agreement between Paramount and Yost since such an agreement requires a community of interest in the enterprise, a sharing of profits and losses, and a joint participation in the conduct of the business. *Adams Mfg. and Eng. Co. v. Coast Centerless Grinding Co.*, 184 Cal. App. 2d 649, 7 Cal. Rptr. 761 (1960); *Hayward's v. Nelson*, 143 Cal. App. 2d 807, 299 P.2d 1013 (1956); *McCullough v. Krammerer Corp.*, 166 F.2d 759, 763 (9th

Cir. 1948), *cert. den.* 335 U.S. 813; 28 Cal. Jur. 2d *Joint Adventurers* §3 (1956).

Paramount and Yost may have cooperated closely in their performances, but this must necessarily occur when two parties work on the same project; such co-operation does not imply a joint venture agreement of the type that would allow Paramount to recover in Yost's place.

## II.

### **Dixon Was Not the "Contractor" Within the Meaning of the Miller Act.**

Cal Tech is the Prime Contractor on the Central Engineering Building Project. It alone was in privity with and under contractual duty to the United States, the owner of the land and the new facility. A contractual duty to construct the Central Engineering Building arose out of a Contract between Cal Tech and the United States [Pltf. Ex. 1]. In accordance with Article 6 of the Prime Contract, Cal Tech subcontracted the work to be done to Dixon. The preamble to the contract between Cal Tech and Dixon [Pltf. Ex. 7] expressly states that it is a subcontract under the Prime Contract between Cal Tech and the United States.

The fact that Dixon, under subcontract with Cal Tech, undertook to perform all of the physical work required to be performed by Cal Tech under the Prime Contract does not alter the fact that Dixon is a subcontractor rather than a prime contractor. Although the Miller Act itself does not define the term "subcontractor," it has been defined generally as including one who contracts with another to perform *a part or all* of the obligation which the second party owes by con-

tract to a third party. See the discussion on pages 11-12, *supra*, and the authorities cited therein. The approach taken in those authorities has been adopted in a number of cases. In *Smith v. Wilcox*, 44 Or. 323, 74 Pac. 708 (1903), subsequent opinion at 44 Or. 323, 75 Pac. 710 (1904), the G. H. Dammeir Company sold land to the defendant and at the same time contracted to erect a house on the land. The Dammeir Company then contracted with the plaintiff for the latter to do all the construction work. The court held the plaintiff was a subcontractor rather than a prime contractor since:

“‘A subcontractor is one who has entered into a contract, express or implied, for the performance of an act with the person who has already contracted for its performance.’ Phillips, Mech. Liens (3d. Ed.) §44. A subcontract is defined to be ‘a contract by one who has contracted for the performance of labor services with a third person for the whole or part performance of the labor or service.’ Bouvier, Law Dict. The term ‘subcontractor’ therefore is not inappropriate to designate one who has contracted with the principal contractor to perform the whole as well as a part of the service which the latter has undertaken to perform.” (*Id.* at 709.)

See also, *Arcweld Mfg. Co. v. Burney*, 12 Wash.2d 212, 121 P.2d 350 (1942).

Thus, as a matter of law and fact, there can be no doubt that Cal Tech is the Prime Contractor in this project, and that Dixon is a subcontractor. Under the *MacEvoy* Rule, *supra*, only a materialman, laborer, or subcontractor who is in privity of contract with Dixon



can make a claim under the Miller Act Bond involved in this action, and Harris alone is in privity with Dixon. One case has made an exception to this general rule by holding that a "supervisory agent" of the government is not to be considered the "contractor" under the Miller Act. *United States for the Use of West Pacific Sales Co., Inc. v. Harder Industrial Contractors, Inc.*, 225 F. Supp. 699 (D.Ore. 1963). No evidence was introduced in the present action to show that Cal Tech was such a supervisory agent and hence a finding that Dixon was the "Contractor" under the Miller Act is erroneous.

Part III, Division 2, page 24 of the Specifications of the project [Pltf. Ex. 8] do refer to Cal Tech as the agent of the United States, but this is only in reference to the purchase of equipment and hence not in point. The fact that the specifications identify Cal Tech as the agent of the United States for that particular purpose is evidence that Cal Tech is not such an agent for other purposes.

### III.

#### **Proof of a Promise by Dixon to Indemnify Paramount for the Cost of Materials and Labor Which Yost Would Not Pay for Is Barred by the California Statute of Frauds.**

Paramount produced testimony, over objection, to the effect that it had supplied \$431.09 worth of material and labor to the construction project in reliance on an alleged promise by Dixon to pay for that labor and material if Yost failed to pay for it [R. T., Vol. I, p. 65, line 10, to p. 69, line 1; C. T., p. 167, line 32, to p. 168, line 3]. Statute of frauds. California Civil

Code, Section 1624(2); *Clay v. Walton*, 9 Cal. 328 (1858); 23 Cal. Jur. 2d, *Frauds, Statute of*, §89 (1955). In *Clay, supra*, the defendant orally promised a material supplier that he would be responsible for any material sold thereafter to a contractor who was building a house for the defendant. The court held that this promise was unenforcible since within the Statute of frauds. Since the instant case is identical with *Clay*, the District Court's finding that Paramount was entitled to recover said sum from Dixon [C. T., p. 167, line 128, p. 168, line 3] is erroneous.

#### IV.

#### **The District Court Erred in Holding That There Was No Written Contract Between Harris and Dixon.**

On or about June 21, 1962, Dixon received by mail a written Subcontract [Pltf. Ex. 3] accompanied by a letter of transmittal [Pltf. Ex. 5]. Both the letter and the subcontract were signed by Harris. The letter expressed a desire to use a subcontractor and to perform the work in two "move-ins." The Subcontract required written approval by Dixon of all subcontractors and required Harris to prosecute the work with diligence [Pltf. Ex. 3, paras. 21 and 6]. The District Court held that the terms of the letter and the subcontract conflicted; that there had been no meeting of the minds between Harris and Dixon; that Dixon had never accepted the counteroffer contained in Harris' letter; and, hence, that there was no valid written contract between Harris and Dixon [C. T., p. 169, line 12, to p. 171, line 2]. It is respectfully submitted that the above findings are not supported by evidence and are contrary to law.

The evidence shows that Harris commenced performance near the beginning of July. Sometime later, Dixon's job superintendent was told that Yost was a subcontractor of Harris [C. T. p. 170, lines 5-9]. Dixon's only objection to this subcontract was made in September [R. T., Vol. I, p. 78, line 3, to p. 80, line 22]. Clearly performance by Dixon for over a month with knowledge of the Harris-Yost subcontract was acceptance of that subcontract. *Beatty v. Oakland Sheet-metal Supply Co.*, 111 Cal. App. 2d 53, 244 P.2d 25, 30 (1952); cf. *Trubowitz v. Riverbank Canning Co.*, 30 Cal. 2d 335, 182 P.2d 182 (1947).

The work to be performed by Harris involved the excavation of a foundation and basement area and the placing of dirt between the foundation walls and the surrounding earth ("backfilling"). The pouring of the concrete foundation was to be done by another subcontractor. The most economical method of performing Harris' work would be in two move-ins of men and equipment: one to excavate the earth and one to do the backfilling. The provision in the Dixon-Harris Subcontract requiring Harris to perform the work diligently [Pltf. Ex. 3, para. 6] did not require Harris to keep men and equipment standing idle while the concrete was being poured, and hence there is no conflict between the written subcontract and Harris' letter on the subject of the number of move-ins. Furthermore, the evidence at the trial is that the work was performed in two move-ins [R. T., Vol. II, p. 191, line 18, to p. 194, line 10; p. 327, lines 17-21].

The District Court found that after Harris had abandoned the work, Dixon used a number of different contractors at different times and hence the work could

not have been performed in two move-ins [C. T., p. 170, lines 17-24]. This finding is erroneous since, for a number of reasons, it has no bearing on what Harris agreed to and was able to do. In the first place, Dixon was not required to complete performance of Harris' work in accordance with the terms of the subcontract (although any deviation may or may not affect the damages recoverable). In the second place, the number of move-ins actually made had little bearing on how many move-ins could have been made. In the third place, whether it was possible to perform the work in two move-ins is irrelevant to the issue of whether Harris and Dixon contracted to perform it in two move-ins.

The evidence, therefore, is that Harris returned the subcontract accompanied with (perhaps) a counteroffer requesting permission to use a subcontractor and to perform the work in two move-ins. Thereafter, the parties commenced to perform according to the terms of the subcontract. Payments were made by Dixon to Harris in accordance with the subcontract. Dixon knew Harris was using a subcontractor without authorization but did not complain for well over a month. This complaint was never insisted upon. The work was performed in two move-ins. On this evidence the court found that there had not been a "meeting of the minds." It is respectfully submitted that Dixon's actions in proceeding to perform after receipt of the "counteroffer" was an acceptance of that counteroffer. See: *Beatty v. Oakland Sheetmetal Supply Company*, 111 Cal. App. 2d 53, 244 P.2d 25, 30 (1952); *Fidelity & Casualty Co. v. Fresno Flume & Irrigation Co.*, 161 Cal. 466, 473, 119 Pac. 646, 648 (1911). Any insistence by Dixon that Harris could not use a subcon-

tractor would have been a breach of the contract and would not have had the effect of retroactively annulling a contract accepted by a course of conduct extending well over a month. Thus, the parties' minds did meet and an express contract existed between Dixon and Harris.

V.

**The District Court Erred in Finding That Dixon Prevented Performance by Harris by Insisting Upon Labor and Material Releases.**

The District Court found that Dixon prevented Harris from performing any contract between them by refusing to make progress payments to Harris unless Harris provided releases from Yost and Paramount [C. T., p. 171, lines 3-15]. If, as the District Court found, there was only an implied contract between Harris and Dixon, then Harris was not entitled to progress payments as provided in the writing and Dixon did not prevent Harris' performance in any manner. *Smoll v. Webb*, 55 Cal. App. 2d 456, 130 P.2d 773 (1942). The District Court also notes that if the written subcontract controlled, then Dixon had no right to demand releases as a condition precedent to the progress payment [C. T., p. 171, lines 15-28]. This is clearly erroneous since paragraph 3 of the subcontract between Harris and Dixon [Pltf. Ex. 3] incorporates by reference the terms of the plans and specifications of the General Contract, as the District Court found [C. T., p. 165, lines 15-18]. Paragraph 10 of the GENERAL CONDITIONS of the Specifications [Pltf. Ex. 8] allows retention of progress payments until releases from all materialmen and subcontractors are provided. In addition, the paragraph of the sub-

contract [Pltf. Ex. 3] entitled "Payment Schedule" provides that the subcontractor shall be paid "in accordance with the terms provided for in the General Contract provided for the payment of progress payments to the General Contractor. . . ." These provisions incorporate by reference the provision for releases of the General Contract into the subcontract.

It is the well settled rule in California that:

"One written agreement may, by express reference, incorporate other written agreements; in such a case the agreement making reference and those referred to must be construed as one contract." (12 Cal.Jur.2d *Contracts*, §123 (1953)).

This rule has often been applied in situations where a subcontractor expressly incorporates by reference the prime contract.

In *Gray v. Cotton*, 166 Cal. 130, 134 Pac. 1145 (1913), a subcontract provided that the plaintiff would perform certain work "in accordance with the plans and specifications as prepared by city engineer." The specifications provided that payment was to be made upon the city engineer's estimate of the amount of work performed. Plaintiff-subcontractor contended that the reference in the subcontract to the specifications related only to the performance of the work and not to the method of payment. The court held, however, that the method of payment was covered by the specifications and so was incorporated into the subcontract. This principle was reiterated and applied in *Holbrook*



*v. Fasio*, 84 Cal. App. 2d 700, 191 P.2d 123 (1948), where the court held that:

“The issue on this appeal is whether when a general contract is incorporated into a subcontract by reference the terms of the general contract relating to method and time of payment become a part of the subcontract.

“The answer is in the affirmative.”

See also, *Trottier v. M. H. Golden Construction Company*, 105 Cal. App. 2d 511, 233 P.2d 675 (1951).

The written subcontract between Dixon and Harris [Pltf. Ex. 3] presents the same problem as in *Holbrook, supra*, and should receive the same answer. The paragraph entitled PAYMENT SCHEDULE states that:

“The Contractor agrees to pay the Subcontractor progress payments monthly in accordance with the terms provided for in the General Contract for the payment of progress payments to the General Contractor. . . .”

Additionally, the written subcontract provides in paragraph 3 that:

“The Subcontractor agrees that said General Contract, together with said plans, drawings, specifications, and addenda, are incorporated in the Subcontract by reference with the same force and effect as if the same was set forth herein at length, and that he will be and is bound by any and all parts of said General Contract, plans, drawings, specifi-

cations, and addenda in so far as they relate in any part or way, directly or indirectly, to the work herein undertaken or to the material furnished hereunder.”

These two clauses of the subcontract show a clear intent that all the terms of the contract between Dixon and Cal Tech should be incorporated by reference into the written contract between Dixon and Harris. More specifically, there was an intent to incorporate the method of payment used in the specifications of the prime contract into the subcontract. Paragraph 10 of the GENERAL CONDITIONS of the Specifications [Pltf. Ex. 8] entitled LIENS was intended by the parties to apply to payments made by Dixon to Harris. This conclusion is supported by the common practice among contractors to require releases from materialmen and suppliers for materials supplied prior to a given progress payment before making a progress payment to the subcontractor. Since the subcontract specifically incorporates all the terms of the general contract, the provision regarding liens in the Specifications applies to prevent recovery by Harris against Dixon until the releases required by the Specifications are provided. Thus, regardless of whether Harris had an express or implied contract with Dixon, Dixon did not prevent Harris' performance by conditioning payment on releases.

VI.

**The District Court Erred in Finding That Dixon Breached the Written Subcontract.**

The District Court found that Dixon breached the written subcontract with Harris by (a) refusing to allow stockpiling of reusable excavated material within the job site and (b) failing to provide adequate engineering [C. T. p. 171, line 29, to p. 172, line 8]. These findings are unsupported by evidence. The plans provide that:

“All suitable material shall be deposited on JPL property as selected by the architect. The deposit area must be cleared of all brush and debris. The excess suitable material must be compacted to 90 AASHO. The unsuitable material must be hauled off JPL property at contractor’s expense.” [Deft. Ex. GG, p. C2, Note 7].

Harris did testify that he wasn’t permitted to dump unsuitable earth on the job site [R. T., Vol. III, p. 323, line 18, to p. 324, line 11] but there was no evidence that earth usable for backfilling was not permitted by Dixon to be stockpiled. The uncontradicted testimony of Dixon’s superintendent indicates that material suitable for backfill was stockpiled on the job site [R. T., Vol. II, p. 178, line 7, to p. 179, line 1]; that Harris dumped unsuitable material on the job site [R. T., Vol. II, p. 215, line 4, to p. 216, line 11]; and that an area for stockpiling earth was provided Harris [R. T., Vol. II, p. 289, lines 12-15].

The only evidence as to the engineering concerns the placing of stakes in the ground to control the slope of the embankment. The only evidence on this point is

Harris' testimony that he did not know whether or not certain stakes were properly set and that the cut was not made according to the wishes of Dixon [R. T., Vol. III, p. 320, lines 15-22; p. 334, lines 8-19]; and hence a finding that Dixon improperly engineered the work is unsupported by evidence.

The District Court also noted that Dixon requested that Harris perform certain work not required by the written subcontract [C. T., p. 172, lines 19-21]. There is no evidence in the record that such request was ever complied with or that Harris was prejudiced in any way thereby, and hence such a finding is irrelevant to this action.

For the above reasons, the District Court erred in finding that Dixon breached the written subcontract.

### Conclusion.

For the reasons stated above, it is respectfully requested that the judgment for Paramount Truck Rental, Inc. and Van Harris be reversed and remanded with instructions to enter judgment for appellants L. E. Dixon Company and Fidelity and Deposit Company of Maryland.

THELEN, MARRIN, JOHNSON &  
BRIDGES,  
JAMES W. BALDWIN,  
ROBERT K. WORRELL,  
ANDREW J. NOCAS,

*Attorneys for Appellants L. E. Dixon  
Company and Fidelity and Deposit  
Company of Maryland.*

### **Certificate.**

I Certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit and that, in my opinion, the foregoing brief is in full compliance with those rules.

ANDREW J. NOCAS.









## TABLE OF EXHIBITS.

### Plaintiff Paramount's Exhibits.

No.		Iden.	Recd.
1	U.S.A. - Cal. Tech. Contract	21	21
2	Miller Act Bond	22	22
3	Dixon - Harris Subcontract	23	23
4	Harris - Yost Subcontract	24	24
5	Letter of June 20, 1962, from Harris to Dixon	27	27
6	Letter of June 8, 1962, from Harris to Dixon	31	31
7	Cal. Tech. - Dixon Contract	32	32
8	Specifications for Project	33	33
9	Letter of October 3, 1962, from Dixon to Harris	36	37
10	Letter of October 18, 1962, from Harris to Yost	36	39
11	Letter of November 1, 1962, from Dixon to Harris	36	39
12	Paramount's Daily Work Reports, dated 7-3-62	54	57
13	Paramount's Invoices to Yost, dated 10-16-62	58	60
14	Paramount's Invoice for \$431.69 and supporting documents	64	68
15	Letter of November 9, 1962, from Dixon to Harris	64	69
16	Paramount's Notice of Claims	70	70
17	Paramount's Ledger Cards for Yost	64	72

### Defendant Dixon's Exhibits.

No.		Iden.	Recd.
D	Letters from Dixon to Harris dated between July 16 and November 21	127,161	132,165
D-1	Some of letters from Exhibit D	165	
H	Telegram from Harris to Dixon dated 11-6-62	161	246
I	Summary sheets showing Dixon's weekly costs for backfilling: \$6,748.79	161	201
J	Dixon's bill from Acme Rental for vibratory roller and trailer	161	204
K,L,M	Dixon's billings and payments for rental of bare equipment	161	215
N,O,P	Dixon's invoices, statements and checks	161	212
Q,R,S	Dixon's invoices, statements and checks	161	212
T	Dixon's invoices, statements and checks	161	212
U	Dump fees paid by Dixon for disposal of unsuitable material offsite	161	217
V,X,Y	Dixon's invoices, statements and checks	161	212
Z,AA	Dixon's invoices, statements and checks	161	212
BB,CC	Bills and checks for cement and asphalt emulsion to protect north bank of excavation	161	218
DD	Cost of concrete backfilling on north bank	161	223
EE	Cost of fill sand and crusher run material for backfill	161	223
FF	Bill from Harris for first progress payment	225	
GG	Plans for Project	147	164

### Third Party Defendant Harris' Exhibits.

BA	Letter of August 7, 1962, from Harris to Dixon	257	259
BC	Letter from Harris	272	
BD	Letter from Dixon re stockpiling	285	286

No. 20122

IN THE

# United States Court of Appeals

FOR THE NINTH CIRCUIT

---

UNITED STATES, to the Use of A. F. YOST,  
*Plaintiffs,*

*vs.*

L. E. DIXON COMPANY, *et al.*,  
*Defendants.*

---

L. E. DIXON COMPANY, a corporation,  
*Cross-Complainant,*

*vs.*

VAN HARRIS, an individual doing business as HARRIS &  
SONS, *et al.*,  
*Cross-Defendants.*

---

UNITED STATES, to the Use of PARAMOUNT TRUCK  
RENTAL, INC.,  
*Plaintiff,*

*vs.*

FIDELITY AND DEPOSIT COMPANY OF MARYLAND,  
*et al.*,  
*Defendants.*

---

Opening Brief of Appellant, Paramount Truck  
Rental, Inc. Re Attorneys' Fees.

---

FILED

JUL 23 1955

GREENBERG & GLUSKER,

9720 Wilshire Boulevard,  
Beverly Hills, California,

FRANK H. SCHMID, CLERK

*Attorneys for Appellant,  
Paramount Truck Rental, Inc.*





## TOPICAL INDEX

	Page
<b>I.</b>	
Statement of pleadings and facts re jurisdiction .....	1
<b>II.</b>	
Statement of case .....	2
<b>III.</b>	
Specification of errors .....	3
<b>IV.</b>	
Argument .....	3
A. Under the Miller Act a prevailing use plain- tiff is entitled to recover reasonable attor- neys' fees .....	3
B. If the court determines that State law applies, attorneys' fees must be awarded to the use plaintiff herein under California law .....	6
<b>V.</b>	
Conclusion .....	10

## TABLE OF AUTHORITIES CITED

Cases	Page
B. C. Richter Contracting Co., Inc. v. Continental Gas Co., 230 A.C.A. 540 .....	7
Continental Casualty Co. v. Shaeffer, 173 F. 2d 5 ....	5
Liebman v. California Electric Supply Co., 153 F. 2d 350 .....	5
McWharters and Bartlett v. United States, 272 F. 2d 291 .....	7
Sam Macri & Sons, Inc. v. U.S.A., 313 F.2d 119 ....5,	9
Thompson v. H. Louw Co., 237 S.W. 2d 662 .....	10
United States v. Breeden, 110 F. Supp. 713 .....	3
United States v. Carter, 353 U.S. 210, 1 L. Ed. 2d 776 .....	7
United States v. Fidelity and Deposit Co. of Maryland, 144 F. Supp. 322 .....	4
United States v. Kelley, 327 F. 2d 590 .....	7
United States v. Reliance Ins. Co. of Philadelphia, Pa., 227 F. Supp. 939 .....	7
United States v. Smith Engineering & Construction Co., 240 F. Supp. 189 .....	9
United States v. Texas Construction Co., 237 F. 2d 705 .....	10

Statutes	Page
Alaska Code, Sec. 55-11-51 .....	9
Alaska Code, Sec. 55-11-52 .....	9
Capehart Act, 42 U.S.C. Sec. 1594 .....	7
Government Code, Sec. 4200 .....	6
Government Code, Sec. 4204 .....	6
Government Code, Sec. 4207 .....	7
49 Statutes at Large (1935), p. 793 .....	1
65 Statutes at Large (1951), p. 726 .....	1
69 Statutes at Large (1955), p. 651 .....	7
73 Statutes at Large (1959), p. 323 .....	7
United States Code, Title 28, Sec. 1291 .....	1
United States Code, Title 40, Sec. 270a .....	1
United States Code, Title 42, Sec. 1594 .....	7

#### Textbook

Hume What Law Determines Liability of a Miller Act Surety for Attorney's Fees?, 1965 Ins. Coun- sel J. 134 at 141 (1965) .....	9
--	---



No. 20122

IN THE

# United States Court of Appeals

## FOR THE NINTH CIRCUIT

---

UNITED STATES, to the Use of A. F. YOST, *Plaintiffs,*

*vs.*

L. E. DIXON COMPANY, *et al.,* *Defendants.*

---

L. E. DIXON COMPANY, a corporation, *Cross-Complainant,*

*vs.*

VAN HARRIS, an individual doing business as HARRIS & SONS, *et al.,* *Cross-Defendants.*

---

UNITED STATES, to the Use of PARAMOUNT TRUCK RENTAL, INC., *Plaintiff,*

*vs.*

FIDELITY AND DEPOSIT COMPANY OF MARYLAND, *et al.,* *Defendants.*

---

Opening Brief of Appellant, Paramount Truck Rental, Inc. Re Attorneys' Fees.

---

I.

### STATEMENT OF PLEADINGS AND FACTS RE JURISDICTION.

This is an action under the Miller Act, 40 United States Code, Section 270a, 49 Statutes 793 (1935), *et seq.*, over which the District Court had jurisdiction and, the Judgment of which is reviewable on appeal to this court pursuant to 28 United States Code, Section 1291, 65 Statutes 726 (1951).

## STATEMENT OF CASE.

By its Order Amending or Clarifying Pre-Trial Conference Order [Clk. Tr. p. 104] the Court below placed in issue the question of whether use plaintiff, Paramount Truck Rental, Inc. (hereafter Paramount), was entitled to recover reasonable attorneys' fees along with its general damages, if it secured judgment under the Miller Act. At the trial, Paramount adduced ample evidence from which the court could have determined what would constitute a reasonable attorneys' fees in this case. [Rep. Tr. Vol. 1, pp. 116-122.]

However, the court subsequently held that although Paramount secured judgment in its favor under the Miller Act, it was not entitled to recover reasonable attorneys' fees thereunder. The specific holding of the Court below is as follows [Memo. Op., Clk. Tr. p. 162 at 168]:

“With respect to the contention of Use Plaintiff, Paramount, that it is entitled to recover reasonable attorneys' fees herein from Dixon, the court concludes that such item is not recoverable. The law of the State of California, except where provided by State statute or agreement between the parties, does not permit the recovery of attorneys' fees. Here, there is no applicable statute and no agreement between the parties for attorneys' fees.”

Paramount, believing this decision to be patently erroneous, has appealed therefrom [Notice of Cross Appeal, Clk. Tr. p. 182.]



### III.

#### SPECIFICATION OF ERRORS.

Appellant has filed with this honorable court a Statement of Point intended to be relied upon appeal, to wit:

“The District Court erred in finding that Paramount Truck Rental, Inc. is not entitled to recover reasonable attorneys’ fees herein from Fidelity and Deposit Company of Maryland and L. E. Dixon Company.”

### IV.

#### ARGUMENT.

##### **A. Under the Miller Act a Prevailing Use Plaintiff Is Entitled to Recover Reasonable Attorneys’ Fees.**

Although some courts apparently have held that the question of whether or not a prevailing use plaintiff is entitled to recover attorneys’ fees under the Miller Act is to be determined by the law of the State in which the contract is to be performed, Paramount respectfully submits that the better view is that the Miller Act itself provides for and requires the award of attorneys’ fees in behalf of a prevailing use plaintiff.

District Judge Dimond in *United States v. Breeden*, 110 F. Supp. 713 (D.C. Alaska 1953) so held, cogently reasoning as follows:

“The several defendants . . . object to the allowance of any attorneys’ fees whatever in these cases upon the ground that the Miller Act does not envisage or provide for or allow the imposition of attorneys’ fees upon the sureties in payment bonds, . . .

“We must first consider the precise language of the Miller Act in this respect, which is that the payment bond is given ‘for the protection of all persons supplying labor and material in the prosecution of work provided for in said contract for the use of each such person.’ No specific limitation has been found in this Act or in any other federal law which forbids the allowance of attorneys’ fees as part of costs for the persons who are obliged to bring suit on surety company’s bonds. The text of the law would indicate it must have been the purpose of Congress to protect *all persons* supplying labor and material in the prosecution of work on such contracts. *Surely, the Congress cannot have contemplated that the persons supplying such labor and material should be obliged, in the event of the default of the contractors, to pay to their own attorneys without recompense a substantial portion of the amounts actually due them for the labor and materials supplied to the contractors. Such a rule would penalize the suppliers to the advantage of the sureties on the contractors’ bonds. The protection demanded by the law is full protection to the suppliers and not partial protection, as would be the case if the attorneys’ fees of the suppliers who are obliged to bring suit, could not be taxed as a part of the costs.*” (110 F. Supp. at 715, Emphasis supplied.)

Likewise, District Judge Hunter in *United States v. Fidelity and Deposit Co. of Maryland*, 144 F. Supp. 322 (W.D. La. 1956) held that:

“[T]he question as to whether or not such attorneys’ fees can be collected under the Miller Act

in this suit must be determined by the federal law. . . . [W]e think that under the Miller Act, they [the use plaintiffs] are entitled to recover not only the fair rental value of the equipment but also the expense to them of recouping it in cases where the recoupment is from the contractor and was made necessary by his action in retaining it." (144 F. Supp. at 329, emphasis supplied.) And the court hence awarded attorneys' fees to the use plaintiff without in any way seeking to determine or ascertain whether Louisiana law sanctioned the award thereof.

It is submitted that this court has not yet passed upon the question of whether or not attorneys' fees may be awarded to a prevailing use plaintiff under the Miller Act, whether or not State law would sanction same. All the court holds in *Sam Macri & Sons, Inc. v. U.S.A.*, 313 F.2d 119 (9th Cir. 1963) is simply that an Alaska statute permitted an award of attorney's fees to a successful use plaintiff in a Miller Act case, without considering whether such fees may be awarded under the Miller Act itself to a prevailing use plaintiff in the absence of a state statute authorizing the award thereof. Moreover, this court has held on a number of occasions that federal law must be applied in the interpretation of Miller Act cases. See *Continental Casualty Co. v. Shaeffer*, 173 F. 2d 5 (9th Cir. 1949); *Liebman v. California Electric Supply Co.*, 153 F. 2d 350 (9th Cir. 1946).

**B. If the Court Determines That State Law Applies, Attorneys' Fees Must Be Awarded to the Use Plaintiff Herein Under California Law.**

Assuming, but without conceding, that in order to award attorneys' fees to a prevailing use plaintiff under the Miller Act it is necessary to look to State law, applicable State law requires the award of such fees in this case. Both parties agrees that the applicable State law in this case would be that of California.

California Government Code, Section 4200 provides:

"Every person to whom is awarded a contract involving an expenditure in excess of Two Thousand Five Hundred (\$2,500) Dollars for the improvement, erection or construction of any building, road, bridge or other structure, excavating, or other mechanical work for the State, or for any political subdivision or agency of the State shall, before entering upon the performance of the work, file a good and sufficient bond with the officer or body by whom the contract was awarded."

Section 4204 provides in part:

"To be approved, the contractors' bond shall provide that if the person or his subcontractors, fail to pay for any materials, provisions, provender, or other supplies, or teams, used in, upon, for or about the performance of the work contracted to be done . . . that the surety or sureties will pay for the same in an amount not exceeding the sums specified in the bond, *and also, in case suit is brought upon the bond, a reasonable attorneys' fee to be fixed by the court. . .*" (Emphasis supplied.)

And Section 4207 of said Code provides in part:

“ . . . Upon the trial of the action, the court shall award to the prevailing party a reasonable attorney's fee, to be taxed as costs, and to be included in the judgment therein rendered.” (Emphasis supplied.)

The Trial Judge herein apparently takes the position that unless there is a specific California statute authorizing the award of attorneys' fees in a *Miller Act* case, then such attorneys' fees may not be awarded.\*

It is respectfully submitted that the view of the court below is much too narrow and restricted in light of the admitted remedial aspects of the *Miller Act* which requires it to be liberally construed. See *e.g.*,

*United States v. Carter*, 353 U.S. 210, 1 L. Ed. 2d 776 (1957);

*United States v. Kelley*, 327 F. 2d 590 (9th Cir. 1964);

*McWharters and Bartlett v. United States*, 272 F. 2d 291 (10th Cir. 1959);

If a resort must be made to State law, the correct analysis thereof, is set forth in *United States v. Reliance Ins. Co. of Philadelphia, Pa.*, 227 F. Supp. 939 (D. Mont. 1964). There, Judge East reasoned as follows:

“Of course, the jurisdiction of this court in these proceedings is based solely upon the Act of Con-

---

\*This also was the basis of the opinion Judge Friedman in the case of *B. C. Richter Contracting Co., Inc. v. Continental Gas Co.*, 230 A.C.A. 540 at 554 and following, (1964) in a case involving a claim for attorneys' fees under the Capehart Act, 42 U.S.C. Section 1594, 69 Stat. 651 (1955) as amended 73 Stat. 323 (1959), concerning the construction of rental housing for military personnel and their families.

gress involved. *Therefore, we cannot directly deal with applicable remedial acts of the Legislature of Montana for Montana courts, if any there may be, but instead we must look to such remedial acts for guidance as to the legislative announcement of the public policy of the State.*

“Sections 6-401 through 6-404 R.C.M. 1947 relate to public works contractors’ bonds *and are the Montana equivalents of the Miller Act, and therefore must be deemed to be the legislative-announced public policy of that State* as to court remedies in favor of suppliers and materialmen to general contractors engaged in public works and available to persons suing for and making recovery upon surety bonds furnished and supplied in compliance with the legislation.

“Sections 6-404, *supra*, provides, *inter alia*: ‘In any suit or action brought against any such surety or sureties by any such person or corporation . . . the prevailing party shall be entitled to recover . . . attorneys’ fees and such sums as the court shall adjudge reasonable.’

“Since the rule of state law applicability applies, this court must employ the public policy of the State of Montana, as announced in the provisions of Section 6-404, as the remedial adjunct to the Miller Act.

“Accordingly, I hold that the prevailing use plaintiff herein is entitled to recover as compensation for his attorneys such sum as the court shall adjudge reasonable for the institution and prosecution of these proceedings.” (Emphasis supplied.)



In accord is the recent decision by Chief Judge Carswell in *United States v. Smith Engineering & Construction Co.*, 240 F. Supp. 189 (N.D. Fla. 1965) where the prevailing Miller Act use plaintiff was awarded attorneys' fees under a Florida statute which (1) was enacted *subsequent* to the signing of the contract therein involved (2) and which was specifically made applicable only to payment bond "written by the insurer under the laws of Florida." In rejecting the bonding company's argument that the bond in question was written to comply with the Miller Act and not the laws of Florida, the court stated that the "Florida statute is not to be construed so narrowly" and that "Its impact is not limited to bonds required by the State of Florida." (240 F. Supp. at 192.)

It likewise would appear that this honorable court in the *Macri* case (*supra* 313 F. 2d 119) itself adopted Judge East's philosophy that the State statute need not specifically authorize the award of attorneys' fees to a successful use plaintiff in a Miller Act case so long as the *public policy* of the State indicates the propriety of the award of such fees. In an article by Hume, "What Law Determines Liability of a Miller Act Surety for Attorney's Fees?", 1965 Ins. Counsel J. 134 at 141 (1965) the author notes that the sections of the Alaska code relied on by this honorable court in *Macri* (*i.e.*, Sections 55-11-51 and 55-11-52 A.C.L.A.) "simply provide that a *State court* of Alaska may in its discretion award attorney's fees as part of the 'costs' *in a suit in a State court.*" (Emphasis supplied.)

Thus, technically, since the *Macri* action was brought in a *federal* court, it would appear clear that the Alaska statutes relied on by this court to authorize the award

of attorney's fees in a Miller Act action did not specifically authorize the award thereof but, rather, merely indicated, as so clearly do the California statutes, that the public policy of Alaska sanctioned the award of attorneys' fees to the successful use plaintiff in the Miller Act action.

Likewise, the Texas statute relied upon by Circuit Judge Reeves as authorizing the award of attorney's fees to a successful use plaintiff in a Miller Act action in the case of *United States v. Texas Construction Co.*, 237 F. 2d 705 (5th Cir. 1955) has been interpreted by a Texas State appellate court to apply only to state claims and causes of actions and not to claims based on a federal statute, *Thompson v. H. Louw Co.*, 237 S.W. 2d 662 (Tex. Cir. Ct. App. 1951). Thus, the Fifth Circuit too must have reasoned that it is the policy of a state statute, rather than its literal applicability, which justified the award of attorney's fees to a prevailing Miller Act use plaintiff.

## V.

### CONCLUSION.

It is respectfully submitted that the court below erred in determining that it is not permitted either under the Miller Act itself or under California law to award attorney's fees to Paramount, the prevailing use plaintiff herein. This honorable court should therefore reverse that portion of the trial court's judgment so holding and remand the case for an award to Paramount of reasonable attorney's fees incurred in the trial of this action and on the appeal and cross-appeal pending before this court.

GREENBERG & GLUSKER,

By RICHARD H. FLOUM,

*Attorneys for Appellant.*

### **Certificate.**

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

RICHARD H. FLOUM



No. 20122

IN THE

# United States Court of Appeals

FOR THE NINTH CIRCUIT

---

UNITED STATES, to the Use of A. F. YOST,

*Plaintiffs,*

*vs.*

L. E. DIXON COMPANY, *et al.*,

*Defendants.*

---

L. E. DIXON COMPANY, a corporation,

*Cross-Complainant,*

*vs.*

VAN HARRIS, an individual doing business as HARRIS &  
SONS, *et al.*,

*Cross-Defendants.*

---

UNITED STATES, to the Use of PARAMOUNT TRUCK  
RENTAL, INC.,

*Plaintiff,*

*vs.*

FIDELITY AND DEPOSIT COMPANY OF MARYLAND,  
*et al.*,

*Defendants.*

---

Reply Brief of Appellant, Paramount Truck Rental,  
Inc. Re Attorneys' Fees.

---

GREENBERG & GLUSKER,

9720 Wilshire Boulevard,  
Beverly Hills, California,

*Attorneys for Appellant,*

*Paramount Truck Rental, Inc.*

FILED

SEP 3 1965

FRANK H. SCHMID, CLERK





## TOPICAL INDEX

	Page
Reply brief of appellant, Paramount Truck Rental, Inc. Re Attorneys' fees .....	1
Conclusion .....	4

---

## TABLE OF AUTHORITIES CITED

### Cases

B. C. Richter Contracting Co. v. Continental Casualty Co., 230 Cal. App. 2d 491, 41 Cal. Rptr. 98 .....	2, 4
Bard v. Koerner, 279 F. 2d 623 .....	3
Continental Casualty Co. v. Schaeffer, 173 F. 2d 5 ..	4
Liebman v. California Electric Supply Co., 153 F. 2d 350 .....	4
Silas Mason Co. v. Tax Comm., 302 U.S. 186, 82 L. Ed. 187 .....	4
Sola Elect. Co. v. Jefferson Elect. Co., 317 U.S. 173, 87 L. Ed. 165 .....	2
United States v. Reliance Insurance Co. of Phila- delphia, Pa., 227 F. Supp. 939 .....	5
United States v. United Airlines, Inc., 216 F. Supp. 709 .....	3

### Textbooks

54 American Jurisprudence, Sec. 352 .....	4
20 American Jurisprudence 2d, Sec. 208 .....	4
20 American Jurisprudence 2d, Sec. 222 .....	4
59 Harvard Law Review, p. 956 .....	4
1a Moore's Federal Practice, Sec. 0.183 .....	4



No. 20122  
IN THE  
**United States Court of Appeals**  
FOR THE NINTH CIRCUIT

---

UNITED STATES, to the Use of A. F. YOST,  
*Plaintiffs,*  
*vs.*  
L. E. DIXON COMPANY, *et al.*,  
*Defendants.*

---

L. E. DIXON COMPANY, a corporation,  
*Cross-Complainant,*  
*vs.*  
VAN HARRIS, an individual doing business as HARRIS &  
SONS, *et al.*,  
*Cross-Defendants.*

---

UNITED STATES, to the Use of PARAMOUNT TRUCK  
RENTAL, INC.,  
*Plaintiff,*  
*vs.*  
FIDELITY AND DEPOSIT COMPANY OF MARYLAND,  
*et al.*,  
*Defendants.*

---

**Reply Brief of Appellant, Paramount Truck Rental,  
Inc. Re Attorneys' Fees.**

---

Appellant and Use Plaintiff, Paramount Truck Rental, Inc., has carefully read and considered the arguments and authorities contained in the Reply Brief of Appellees, Fidelity and Deposit Company of Maryland and L. E. Dixon Company, on the issue of at-

torneys' fees and finds nothing contained therein which requires it to change or withdraw from any of the positions asserted in its Opening Brief.

There is, however, one point raised in said Reply Brief that requires answering. Appellees take the position that this Honorable Court is bound by the decision of an intermediate California Appellate Court rendered in *B. C. Richter Contracting Co. v. Continental Casualty Co.*, 230 Cal. App. 2d 491, 41 Cal. Rptr. 98 (1964). Thus, appellees state that said decision "has . . . rendered the question [of whether Miller Act attorneys' fees are awardable under California law] academic . . ." (Reply Br. p. 7, second full paragraph, lines 5 and 6) and, again, that the *Richter* decision "conclusively prohibits such an award under California law." (Reply Br. p. 10, lines 7-8.)

But in so arguing, appellees completely misconceive the nature of the power and duties of a federal court in construing a *federal statute*, such as the Miller Act.

The leading opinion on this question is by Mr. Chief Justice Stone in *Sola Elect. Co. v. Jefferson Elect. Co.* 317 U.S. 173, 87 L. Ed. 165 (1942).

Justice Stone wrote there as follows:

"It is familiar doctrine that the prohibition of a federal statute may not be set at naught, or its benefits denied, by state statutes or state common law rules. In such a case our decision is not controlled by *Erie R. Co. v. Tompkins*, 304 U.S. 64. 82 L. ed. 1188, 58 S. Ct. 817, 114 A.L.R. 1487.

There we followed state law because it was the law to be applied in the federal courts. But the doctrine of that case is inapplicable to those areas of judicial decision within which the policy of the law is so dominated by the sweep of federal statutes that legal relations which they affect must be deemed governed by federal law having its source in those statutes, rather than by local law. [citing numerous authorities] When a federal statute condemns an act as unlawful, the extent and nature of the legal consequences of the condemnation, though left by the statute to judicial determination, are nevertheless federal questions, the answers to which are to be derived from the statute and the federal policy which it has adopted. To the federal statute and policy, conflicting state law and policy must yield."

This honorable court has recognized and applied this principle in the recent case of *Bard v. Koerner*, 279 F. 2d 623 (1960) where in an opinion by Judge Barnes, it is stated:

"There is no question but *that in diversity cases* the rule of *Erie R. Co. v. Tompkins* . . . requires the federal courts to ascertain and follow what the State law is if the State decisions are sufficiently conclusive, definite and final. *But the Erie rule excepts 'matters governed by the Federal Constitution or by Acts of Congress'.*" (279 F. 2d at 627 Emphasis supplied.)

Accord:

*United States v. United Airlines, Inc.*, 216 F. Supp. 709, 720 (*E.D. Wash.* 1962);

*Silas Mason Co. v. Tax Comm.*, 302 U.S. 186,  
82 L. Ed. 187 (1937);

1a *Moore's Federal Practice*, Sec. 0.183 *et seq.*;  
54 Am. Jur., *United States Courts*, Section 352;  
20 Am. Jur. 2d, *Courts*, Sections 222 and 208;  
and

59 Harv. L. Rev. 956.

And pursuant to this principle, this court has thus recognized on more than one occasion that *federal law* must be applied in the interpretation and construction of the Miller Act. See *Continental Casualty Co. v. Schaeffer*, 173 F. 2d 5 (9th Cir. 1949); *Liebman v. California Electric Supply Co.*, 153 F. 2d 350 (9th Cir. 1946). And the authorities reviewed above demonstrate that in formulating this federal law, federal courts are *not* bound by a State court's characterization of the scope and effect thereof.

### Conclusion.

Paramount reiterates the conclusion contained in its Opening Brief that the court below erred in determining that it is not permitted either under the Miller Act itself or under California law to award attorneys' fees to Paramount, the prevailing use plaintiff herein. As demonstrated herein, this court is not bound by nor should it follow the narrow and restricted interpretation placed on the Miller Act by the State court judge in the *B. C. Richter case*. Rather in furtherance of the purposes of the Miller Act, it should follow and adopt the



more liberal and better reasoned analysis of District Judge East in *United States v. Reliance Insurance Co. of Philadelphia, Pa.*, 227 F. Supp. 939 (D. Mont. 1964), which analysis is supported by other decisions, including this court's opinion in *Macri*, digested at pages 9 and 10 of Paramount's Opening Brief.

Respectfully submitted,

GREENBERG, & GLUSKER,

By RICHARD H. FLOUM,

*Attorneys for Appellant, Paramount  
Truck Rental, Inc.*



### **Certificate.**

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

RICHARD H. FLOUM



Nos. 20121, 20122  
IN THE  
**United States Court of Appeals**  
FOR THE NINTH CIRCUIT

---

FIDELITY AND DEPOSIT COMPANY OF MARYLAND  
and L. E. DIXON COMPANY, *Appellants,*

*vs.*

VAN HARRIS, an individual, doing business as Harris & Sons,  
*Appellee.*

---

FIDELITY AND DEPOSIT COMPANY OF MARYLAND  
and L. E. DIXON COMPANY, *Appellants,*

*vs.*

PARAMOUNT TRUCK RENTAL, INC., and VAN HARRIS,  
an individual doing business as Harris & Sons,  
*Appellees.*

---

PARAMOUNT TRUCK RENTAL, INC., *Appellant,*

*vs.*

FIDELITY AND DEPOSIT COMPANY OF MARYLAND  
and L. E. DIXON COMPANY, *Appellees.*

---

Reply Brief of Appellants L. E. Dixon Company and  
Fidelity and Deposit Company of Maryland.

---

THELEN, MARRIN, JOHNSON & BRIDGES,  
811 West Seventh Street,  
Los Angeles, California,  
*Attorneys for Appellees.*

FILED  
SEP 9 1961  
FRANK H. SCHMID, CLERK





## TOPICAL INDEX

	Page
I.	
Statement of the case .....	1
II.	
Argument .....	4
A. Dixon was not "the Contractor" within the meaning of the Miller Act .....	4
B. Paramount is too far removed from the general contractor to be within the protection of the Miller Act Bond .....	5
C. Proof of a promise by Dixon to indemnify Paramount for the cost of material and labor which Yost would not pay for is barred by the California Statute of Frauds .....	6
D. Dixon's alleged contract with Paramount does not make Dixon liable for Paramount's contracts with Yost .....	9
E. Conferences between employees of Paramount and Dixon cannot create an implied obligation for services rendered to another ....	10
F. Paramount is too far removed from the general contractor to be within the protection of the Miller Act Bond .....	10
Conclusion .....	15

## TABLE OF AUTHORITIES CITED

Cases	Page
Aetna Ins. Co. v. Southern Waldrup and Harwick, 198 F. Supp. 505 .....	5, 6
American Casualty Co. v. Curran Productions, Inc., 212 Cal. App. 2d 386, 28 Cal. Rptr. 131 .....	8
Bushman Construction Co. v. Conner, 307 F. 2d 888	14
Clifford F. MacEvoy Co. v. United States, 322 U.S. 102, 64 S. Ct. 890, 88 L. Ed. 1163 ....	5, 14, 15
Continental Casualty Co. v. United States, 308 F. 2d 846 .....	14
Fine v. Travelers Indemnity Co., 233 F. Supp. 672 .....	10, 12, 13
Green v. Soule, 145 Cal. 96, 78 Pac. 337 .....	3
Gressley v. Williams, 193 Cal. App. 2d 636, 14 Cal. Rptr. 496 .....	7
McGregor Architectural Iron Co. v. Merritt-Chap- man & Scott Corp., 150 F. Supp. 323 .....	5, 6
Noland Co. v. Allied Contractors, Inc., 273 F. 2d 917	9
United States v. Deschesnes Constr. Co. Inc., 188 F. Supp. 270 .....	5
United States v. Ft. George G. Meade, 186 F. Supp. 639 .....	13, 14
United States v. Harder Industrial Contractors, Inc., 225 F. Supp. 699 .....	4, 5
United States v. Idaho Crane and Rigging Co., 193 F. Supp. 802 .....	5, 6
United States v. Pinole, 171 F. Supp. 87 .....	6
Textbooks	
23 California Jurisprudence 2d, Sec. 129, p. 400 ....	8
26 California Jurisprudence 2d, Sec. 2, p. 397 .....	3

Nos. 20121, 20122  
IN THE  
**United States Court of Appeals**  
FOR THE NINTH CIRCUIT

---

FIDELITY AND DEPOSIT COMPANY OF MARYLAND  
and L. E. DIXON COMPANY, *Appellants,*

*vs.*

VAN HARRIS, an individual, doing business as Harris & Sons,  
*Appellee.*

---

FIDELITY AND DEPOSIT COMPANY OF MARYLAND  
and L. E. DIXON COMPANY, *Appellants,*

*vs.*

PARAMOUNT TRUCK RENTAL, INC., and VAN HARRIS,  
an individual doing business as Harris & Sons,  
*Appellees.*

---

PARAMOUNT TRUCK RENTAL, INC., *Appellant,*

*vs.*

FIDELITY AND DEPOSIT COMPANY OF MARYLAND  
and L. E. DIXON COMPANY, *Appellees.*

---

**Reply Brief of Appellants L. E. Dixon Company and  
Fidelity and Deposit Company of Maryland.**

---

I.

**STATEMENT OF THE CASE.**

The Statement of Case in the Reply Brief of appellee Paramount Truck Rental, Inc. (hereinafter referred to as "Paramount") requires the following comments:

The second subpart of paragraph 2 of appellee's Statement of Case (Reply Br. p. 3, first paragraph)

quotes out of context a portion of the specifications of the contract between the California Institute of Technology (hereinafter referred to as "Cal Tech") and L. E. Dixon Company (hereinafter referred to as "Dixon"). The full quotation of that portion of the specifications is as follows:

"61. WARRANTY:

a \* \* \*

b *All Subcontractors', manufacturers', or suppliers'* equipment used in or a part of the work (whether on equipment of the nature above specified or otherwise) shall be deemed obtained by the CIT as the agent of the Government and all such warranties and guarantees shall inure to the benefit of the Government without the necessity of separate transfer or assignment thereof. Submit all written guarantees to JPL. The Contractor shall require such Subcontractors, manufacturers, or suppliers to execute such warranties and guarantees in writing to the Government." [Part 3, Div. 2, paragraph 61(b), pp. 23-24; Plft. Ex. 8.]

This specification is obviously limited in its effect to warranties and guarantees, and was not intended to create a general agency relationship between Cal Tech and the United States Government.

Paragraph 6 (Reply Br. p. 4) states that the agreement between appellee Van Harris (hereinafter referred to as "Harris") and Andrew Franklin Yost (hereinafter referred to as "Yost") [Pltf. Ex. 4] was entered into

two weeks prior to the date Harris returned the signed contract between appellant Dixon and Harris [Pltf. Ex. 3]. The Harris-Yost agreement is dated June 22, 1962, and the Dixon-Harris contract was returned to Dixon with a letter from Harris dated June 20, 1962 [Pltf. Ex. 5]. Nothing in the record indicates that those dates do not represent the actual dates of execution and transmittal of the respective documents and hence the appellee's assertion and the District Court's finding to the contrary are without basis.

In paragraph 10 (Reply Br. p. 5), Paramount asserts that Harris could not have "supervised" the work since he had no control over Yost. Appellants' statement that Harris was supervising the work is based on Harris' testimony [R. T. Vol. 1, p. 44, line 13, to p. 45, line 8], while Paramount bases its assertion to the contrary upon testimony which was stricken from the record on Paramount's motion [R. T. Vol. 1, p. 46, line 16, to p. 47, line 22]. Legally, Harris had no right to control Yost's method of performance of his subcontract, except as provided by the contract documents, since Yost was an independent contractor. *Green v. Soule* (1904), 145 Cal. 96, 78 Pac. 337, 26 Cal. Jur. 2d, *Independent Contractors*, §2, p. 397. In addition, Paramount's direct dealings with Dixon were in accordance with the custom of the industry, wherein sub-subcontractors often deal directly with the prime contractor [R. T. Vol. 1, p. 115, lines 6-25].

## II. ARGUMENT.

### A. Dixon Was Not “the Contractor” Within the Meaning of the Miller Act.

Paramount apparently rests its claim that Dixon was the “Contractor” under the Miller Act solely on the case of *United States v. Harder Industrial Contractors, Inc.* (D.C. Or. 1963), 225 F. Supp. 699, which case, Paramount contends,

“... patently stands for the proposition that for the purpose of the Miller Act, the person who furnishes the performance bond is to be treated as the contractor for the purpose of determining whether or not the use plaintiff has a sufficient nexus therewith.” (Reply Br. p. 14).

The *Harder* decision, in fact, stands for no such broad proposition. The result in that case was based upon finding by the court that Kaiser Engineers was the “supervisory agent” of the AEC. This finding of an agency relationship was, of necessity, based upon the particular factual situation presented. It is unfortunate that the court in *Harder* failed to outline the facts upon which the relationship was based, but it is respectfully submitted that the facts in the present case in no way show that Cal Tech was acting as a mere agent of the Government. The court’s attention is invited to Article I(a) of the Contract between the United States and Cal Tech [Pltf. Ex. 1], wherein the parties thereto agreed that Cal Tech was an independent contractor and not an agent of the United States. Paramount has not, and cannot, point to any evidence in the record upon which to base a finding that Cal Tech was the “supervisory agent” of the Government.



The rule advanced in *Harder* that a supervisory agent should be ignored for the purposes of the Miller Act would seem to be an incorrect interpretation of that Act. That rule is apparently based on the theory that the actual performance of physical labor is the important criterion and that supervision of the work or financial responsibility for the performance of the work is irrelevant. This theory is deficient in that, in every chain of contractors, only one contractor can perform the actual labor. To ignore all the remaining contractors would, in effect, overrule *Clifford F. MacEvoy Co. v. United States* (1944), 322 U.S. 102, 64 S. Ct. 890, 88 L. Ed. 1163. Surely supervision of the work by Cal Tech and financial responsibility for the results should be adequate for the purpose of *Clifford F. MacEvoy Co. v. United States, supra*.

**B. Paramount Is Too Far Removed From the General Contractor to Be Within the Protection of the Miller Act Bond.**

Paramount contends that the decision in *Clifford F. MacEvoy v. United States, supra*, should not apply to the instant case (Reply Br. pp. 15-17). With one exception, however, every court considering this particular point has applied the *MacEvoy* decision to deny relief to suppliers such as Paramount. The one exception is *McGregor Architectural Iron Co. v. Merritt-Chapman & Scott Corp.* (M.D. Pa. 1957), 150 F. Supp. 323, relied upon by appellee. This case has been widely criticized; see *e.g. Aetna Ins. Co. v. Southern Waldrup and Harwick* (N.D. Calif. 1961), 198 F. Supp. 505; *United States v. Deschesnes Constr. Co., Inc.*, (D.C. Mass. 1960), 188 F. Supp. 270; *United States v. Idaho Crane and Rigging Co.* (D.C. Idaho 1961), 193

F. Supp. 802; it has been cited with approval only once to appellants' knowledge, in *United States v. Pinole* (D.C. Calif. 1959), 171 F. Supp. 87, a case which was later disapproved in *Actna Ins. Co., supra*, by the same judge that wrote the opinion in *Pinole*. Thus, it is submitted that *McGregor Architectural Iron Co., supra*, should be given no weight at all in determining the question presented in the instant case.

**C. Proof of a Promise by Dixon to Indemnify Paramount for the Cost of Material and Labor Which Yost Would Not Pay for Is Barred by the California Statute of Frauds.**

On pages 18 and 19 of the Reply Brief, Paramount attempts to show that the statute of frauds does not bar proof of Dixon's alleged promise to pay for materials and labor which Yost would not pay for. The first part of Paramount's argument is based on the contention that Yost was never obliged to pay for the labor and material allegedly furnished at Dixon's request. At the trial, Paramount's Mr. Dick testified as follows:

"A. Mr. Meyers called our dispatcher requesting equipment. Our dispatcher turned the telephone call over to me, and Mr. Meyers then requested certain equipment to be sent to the job.

I told Mr. Meyers that the job was in a dispute and that—

The Court: That the job was what?

A. There was a dispute on the job, and that I could no longer send equipment up there *because Mr. Yost would not allow it*. Mr. Meyers said, well, he needed the equipment, and I said, well, what I would do, I would contact Mr. Yost and *if Mr.*

*Yost would O.K. it* I would send the equipment providing that if Mr. Yost did not pay the bill that he would authorize Dixon Company, and he said that he would authorize the Dixon Company to pay the bill if I didn't receive payment from Mr. Yost.

By Mr. Floum:

Q. And as a consequence of that telephone conversation, was equipment sent to the job?

A. Yes." (Emphasis added). [R. T. Vol. 1, p. 66, line 15, to p. 67, line 8].

The phrase "because Mr. Yost would not allow it" can only mean that Yost had refused to pay for equipment sent to the job, since Yost would have neither reason nor right to forbid Paramount from supplying equipment to the job. Similarly, the phrase "if Mr. Yost would O.K. it" can only mean that Paramount would send the equipment if Yost would promise to pay for it. Equipment was sent to the job and hence the inference is that Yost did promise to pay for it. Since Yost was contractually bound to pay for the equipment, Dixon's alleged promise is barred by the statute of frauds.

Paramount's other contention with regard to the statute of frauds is that the promise sued upon is a "fully performed" oral contract. If that were true, then Paramount would obviously have no claim for the \$431 alleged to be owed by Dixon. Additionally, any claim by Paramount that there was part performance of the alleged oral agreement would not prevent application of the statute of frauds since "the mere rendition of services is not usually such a part performance of an oral contract as will relieve the contract of the operation of the statute [of frauds]." *Gressley v. Williams* (1961), 193 Cal. App. 2d 636, 14 Cal. Rptr. 496. Also,

part performance of an alleged promise to answer for the debt of another can never be sufficient to take the promise out of the statute of frauds since such part performance cannot constitute unequivocal evidence of such promise. This rule is stated in 23 Cal. Jur. 2d, *Frauds, Statute of*, Section 129, page 400:

“To remove an oral contract from the operation of the statute of frauds, the acts of performance relied on for that purpose must be unequivocally referable to the oral agreement alone. \* \* \* The acts relied upon must clearly appear to have been performed in pursuance of a particular contract itself and not because of the existence of some other contractual relationship or from some other reason. It is not enough, therefore, that the acts of part performance relied on amount to evidence of some contractual agreement. The acts in question must constitute unequivocal and satisfactory evidence only of the contract sought to be removed from the operation of the statute.”

See also, *American Casualty Co. v. Curran Productions, Inc.* (1963), 212 Cal. App. 2d 386, 28 Cal. Rptr. 131. In light of Paramount's past contracts with Yost, and in light of the fact that Yost had an existing contract to perform the services Paramount performed, it is evident that Paramount's actual performance points with equal force to a contract with Yost as to a contract with Dixon. Hence, by the above rule, Paramount's part performance is insufficient to take the alleged oral agreement with Dixon out of the prohibition of the statute of frauds.

**D. Dixon's Alleged Contract With Paramount Does Not Make Dixon Liable for Paramount's Contracts With Yost.**

In its Reply Brief, Paramount advances the novel theory that Dixon's alleged contract with Paramount for the latter to perform services of the value of \$431 makes Dixon liable for over \$8,000 worth of services rendered by Paramount to Yost (Reply Br. pp. 19-20). Adoption of such a rule would make it extremely risky if not impossible for a prime contractor to enter into contracts with any of the subcontractors or material-men on the job after they had performed any work for any one else on that same job. It should be noted that the decision in *Noland Co. v. Allied Contractors, Inc.* (4th Cir. 1959), 273 F. 2d 917, relied upon by Paramount, simply held that certain statutory obligations were not barred by failure to file a claim in time. In our case, Paramount is asking this Court to create a *direct contractual obligation* for \$8,299.78 against Dixon, which obligation did not previously exist. Moreover, Paramount is asking this Court to hold that contracts between Paramount and Yost and an alleged contract between Paramount and Dixon be treated as one contract, and to hold Dixon liable for the total amount. In *Noland, supra*, the court only held that a number of contracts with the *same contractor* were, in effect, one contract for the purpose of the technical defense of a late filed notice. It is respectfully submitted that Paramount can show no authorities, by analogy or otherwise, which support the proposition that the alleged contract for \$431 worth of services renders Dixon liable for over \$8,000 worth of services *previously rendered by Paramount to a different contractor*.



**E. Conferences Between Employees of Paramount and Dixon Cannot Create an Implied Obligation for Services Rendered to Another.**

On page 21 of the Reply Brief Paramount contends that direct dealings between employees of Dixon and employees of Paramount created an "implied contract" to pay for services rendered. This contention is amply refuted by Paramount's own witness, who stated that it is the practice for subcontractors to confer with the job superintendent of the general contractor [R. T. Vol. 1, p. 103, lines 7-25]. Such a rule would make it impossible for the general contractor to synchronize the work of the subcontractors, as is the general custom [R. T. Vol. 1, p. 103, lines 7-12].

**F. Paramount Is Too Far Removed From the General Contractor to Be Within the Protection of the Miller Act Bond.**

On pages 21 through 27 of the Reply Brief Paramount cites a number of cases in support of its "paper subcontractor" theory. In *Fine v. Travelers Indemnity Co.* (W. D. Mo. 1964), 233 F. Supp. 672 (cited in Reply Br. p. 23), S. S. Silberblatt, Inc., contracted with the Government to construct military housing. The defendants alleged that Silberblatt then subcontracted the work to Sterling Brukar, Inc., who subcontracted with Conner, who in turn subcontracted with the use plaintiff. Actually, the facts showed that *no subcontract had ever been entered into between Silberblatt and Sterling Brukar*. The court in *Fine* discussed the facts and explained its holding as follows:

"It is, of course, true that certain moneys were routed through the corporate books of Sterling



Brukar, Inc., but that corporation had no money or risk in the 'contract' it allegedly 'negotiated'. *It existed only in the mind of the joint president of the two family corporations [S. S. Silberblatt and Sterling Brukar, Inc.] It was never reduced to writing and was but a creation of convenience of one man, S. S. Silberblatt, who supposedly acted simultaneously for both corporations. We hold that such a relationship is not the sort of contractual relationship legally intended to limit liability on a bond required by federal law.*" (*Id.* at 682) (Emphasis added).

In addition to this finding, the court also found that, as to the alleged subcontract between Sterling Brukar and Conner,

"The parties involved merely made a deal under which Conner, without any financial responsibility, stood a change to share the difference between the payments that would be received by the prime contractor for the portion of the work that Conner was supposed to do and the cost of that work which would be borne by moneys furnished by persons other than Conner.

"Legally, such an agreement could well be labeled a 'joint venture'; in the construction industry such deals are sometimes called just that . . ." (*Id.* at 682).

It should be noted that the court, in speaking of the 'parties involved' in the quotation, above was referring to Silberblatt and Conner, since it had already dispensed of Sterling Brukar as a fictitious party. Thus, the court was in effect saying that the agreement between Sil-

berblatt and Conner was never intended to be a subcontract, but rather was in the nature of a joint venture whereby Conner was to perform the work and Silberblatt to contribute the financial backing. This is well pointed up by the statement of the court, that:

“The Silberblatt organization knew from the outset that Conner could not possibly perform on his own financial ability *and the agreement between them accurately reflected that fact*. Even on paper, Sterling Brukar, Inc., was to be the banker for the work that was to be performed by Conner, although the other facts clearly establish that Sterling Brukar, Inc., was acting only as a shadow for S. S. Silberblatt, Inc., in making that financial commitment. *S. S. Silberblatt, Inc., through its president, knew exactly who was financially responsible* from the outset and defendant bonding company, of course, is presumed to have had that same knowledge.” (*Id.* at 682) (Emphasis added).

The factual situation of the *Fine* case, when completely stated, bears not even the faintest resemblance to the case at hand. There, the alleged subcontract between Silberblatt and Sterling Brukar was not committed to writing, and, as the court found, existed only in the mind of one individual—the joint president of both corporations; in the instant action, by contrast, the subcontract between Dixon and Harris was a written, arms-length agreement between two entirely independent parties. There, the contract between Sterling Brukar and Conner was found to be an agreement in the nature of a joint venture between Silberblatt and Conner under which Conner assumed no financial responsibility; in the instant action, however, the subcontract between

Harris and Yost presented none of the elements of a joint venture agreement (Op. Br. pp. 20-21), carried with it full financial responsibility on the part of Harris, and was unknown to Dixon until after it was executed (Reply Br. p. 5, paragraph number 9). It is therefore submitted that *Fine v. Travelers Indemnity Co. supra*, has no bearing on the case now before the court.

In *United States v. Ft. George G. Meade* (D.C. Md. 1960), 186 F. Supp. 639 (cited in Reply Br. p. 24), Miller entered into a contract with the Government under which he was designated the "eligible builder." This original contract named McCloskey as the "principal subcontractor" and authorized Miller to sublet the whole of the contract to McCloskey. Miller did, in fact, sublet the entire contract to McCloskey and agreed to pay him \$16,500,000, the identical contract price for which Miller had agreed to perform the original contract. McCloskey then subcontracted a portion of the work to Acme who in turn subcontracted a portion to the use plaintiff.

The case came up on a motion to dismiss by defendants on the ground that the use plaintiff was too far removed from the prime contractor to recover under the Capehart Act bond. The use plaintiff, on the other hand, alleged that McCloskey rather than Miller was the prime contractor either on the theory that there was a "complete assignment of the Housing Contract" (and not merely an assignment to McCloskey of Miller's responsibilities) or that the agreement between Miller and McCloskey was a joint venture.

The holding of the court was that, since for purposes of the motion it had to accept the allegations of

assignment and joint venture as true, the motion to dismiss should be denied. The court, as *dictum*, stated

“ . . . and with the recital in the housing contract in regard to McCloskey’s financial responsibility and experience it would appear that the Department was looking to McCloskey as the one who was to do the work and intended and agreed that there would be a complete substitution of McCloskey for Miller. . . .” (*Id.* at 650).

The *Ft. George G. Meade, supra*, decision is of no substantive value to the question presented here, since the court in that case, for purposes of the motion, was assuming the existence of a joint venture or novation.

Again, *Continental Casualty Co. v. United States* (5th Cir. 1962), 308 F. 2d 846 (cited in Reply Br. p. 25), has no bearing on the present action. There is no evidence to support the conclusion that the Dixon-Harris subcontract was a sham transaction such as was found in *Continental Casualty Co., supra*, the facts are clear that the agreement Dixon and Harris was an arm’s-length transaction between *independent* parties.

*Bushman Construction Co. v. Conner* (10th Cir. 1962), 307 F. 2d 888 (cited in Reply Br. p. 26), involved a joint venture and hence is irrelevant to this action, as the trial testimony negates the existence of any such relationship (Op. Br. pp. 20-21).

Paramount contends that “technical” contract arguments should not be allowed to interfere with the “remedial” nature of the Miller Act, apparently on the theory that this court should allow full recovery of all losses by subcontractors. The Supreme Court in *Clifford F. MacEvoy Co. v. United States, supra*, however, held otherwise.

**Conclusion.**

The decision in *MacEvoy Co. v. United States, supra*, clearly precludes Paramount from recovering on the Miller Act bond provided by appellants.

Respectfully submitted,

THELEN, MARRIN, JOHNSON &  
BRIDGES,  
JAMES W. BALDWIN,  
ROBERT K. WORRELL,  
ANDREW J. NOCAS,

*Attorneys for Appellants, L. E. Dixon  
Company and Fidelity and Deposit Com-  
pany of Maryland.*





### **Certificate.**

I certify that, in connection with the preparation of this brief, I examined Rules 18 and 19 of the United States Court of Appeals for the 9th Circuit and that, in my opinion, the foregoing brief is in full compliance with those rules.

JAMES W. BALDWIN



No. 20,120

United States Court of Appeals

For the Ninth Circuit

LOUIS HORNER, JOHN L. CONNOLLY, VICTOR ROMERO, JAMES RIEMERS, and HUGH BELL for the benefit of THE PACIFIC COAST DISTRICT OF NATIONAL MARINE ENGINEERS' BENEFICIAL ASSOCIATION, an unincorporated association,

*Appellants,*

VS.

W. A. FERRON, HENRY A. BORELLO, W. H. BUTTRAM, ROBERT H. HORNE, C. W. JENKINS, HARRY LEWIS, R. H. ROBINSON, F. E. WALTON, C. BLACK, H. COLEMAN, S. R. FRANKS, GEORGE B. SALOVICH, FRODE ANDERSEN, FRANCIS H. ROGERS, CHEMICAL BANK NEW YORK TRUST COMPANY, a New York corporation, and FIRST DOE through TENTH DOE, inclusive,

*Appellees.*

Appeal from an Order Denying Application and Motion to File  
Complaint, of the United States District Court for the  
Northern District of California, Southern Division  
Honorable George B. Harris, Chief Judge

BRIEF FOR APPELLEES

JARVIS, MILLER & STENDER,

by MARTIN J. JARVIS,

123 Second Street,

San Francisco, California 94105,

*Attorneys for Appellees.*

FILED

JAN 10 1966

WILLIAM E. WILSON, Clerk



## Subject Index

---

	Page
Statement of the case .....	2
A	
Statement of facts .....	2
B	
Preliminary comments .....	5
Argument .....	7
I	
Summary of the argument .....	7
II	
General rules governing this appeal .....	8
a. If there is anything in the record to sustain the order of the District Court, it must be affirmed on appeal .....	8
b. The burden of showing grounds why the order ap- pealed from should be reversed is on appellants ....	9
c. The question of permitting filing of the proposed com- plaint was addressed to the sound discretion of the trial court .....	9
d. The evaluation of credibility of witnesses, in the exer- cise of discretion, was for the trial court .....	11
e. Federal courts, under LMDRA, should not intervene in every intra-union dispute .....	11
III	
The District Court properly denied appellants' application and motion to file complaint because of lack of juris- diction .....	12
IV	
The District Court properly denied appellants' application and motion to file complaint under the doctrine of res judicata or collateral estoppel .....	13

	Page
V	
There was evidence from which the District Court, in its discretion, must be assumed to have found that good cause did not exist for permitting the filing of the proffered complaint .....	20
a. Applicable law .....	20
b. Facts from which the District Court found that good cause was not established .....	23
1. The appellant who verified the proposed complaint and filed supporting papers was not a member in good standing of the District and only one alleged plaintiff was an active seaman .....	23
2. The MEBA Retirement and Severance Plan was properly adopted .....	24
3. Even if it be assumed, for the sake of argument only, that the MEBA Retirement and Severance Plan was not properly adopted, the Plan was duly ratified by the members of the District .....	28
4. Appellants did not exhaust their internal union remedies .....	37
5. The proposed complaint is stale and barred by the statute of limitations .....	37
6. Appellants did not comply with Rule 23(b), Federal Rules of Civil Procedure .....	4
Conclusion .....	4

## Table of Authorities Cited

Cases	Pages
Adamson v. Gilliland, 242 U.S. 350, 37 S.Ct. 169, 61 L.Ed. 356 .....	11
Aetna Insurance Company v. Eisenberg (8th Cir. 1961) 294 F.2d 301 .....	9
Alvado v. General Motors Corporation (S.D.N.Y. 1961) 194 F.Supp. 314 .....	40
Angel v. Bullington, 330 U.S. 183, 67 S.Ct. 657, 91 L.Ed. 832 .....	15, 17
Broadcast Music v. Havana Madrid Restaurant Corp. (2nd Cir. 1949) 175 F.2d 77.....	11
Burnham Chemical Co. v. Borax Consolidated (9th Cir. 1948) 170 F.2d 569, cert. denied, 336 U.S. 924, 69 S.Ct. 655, 93 L.Ed. 1086, rehearing denied, 336 U.S. 955, 69 S.Ct. 878, 93 L.Ed. 1109, motion denied, 337 U.S. 961, 69 S.Ct. 1529, 93 L.Ed. 1760.....	39, 40
Calhoun v. Bernard (9th Cir. 1964) 333 F.2d 739.....	9
Chapman v. Sheridan-Wyoming Co., 338 U.S. 621, 70 S.Ct. 392, 94 L.Ed. 393.....	15
Chicot County Dist. v. Bank, 308 U.S. 371, 60 Sup.Ct. 317, 84 L.Ed. 329 .....	16
Clinton v. United States (Ct. Cl. 1956) 146 F.Supp. 833, cert. den. 353 U.S. 916, 77 S.Ct. 663, 1 L.Ed.2d 663.....	12
Consolidated Flowers Ship. v. Civil Aeronautics Bd. (9th Cir. 1953) 205 F.2d 449.....	21
Cope v. Anderson, 331 U.S. 461, 67 S.Ct. 1340, 91 L.Ed. 1602 .....	39
Coulter Estate (Sup. Ct. Pa. 1954) 379 Pa. 209, 108 A.2d 681 .....	30
Culver v. Bell & Loffland (9th Cir. 1944) 146 F.2d 29.....	40
DeLman v. Federal Products Corporation (D.R.I. 1955) 136 F.Supp. 241 .....	40
Elmo v. Market St. Ry. Co. (9th Cir. 1942) 124 F.2d 965	10
Ellon v. Board of Pension Commrs. (Sup. Ct. Calif. 1941) 18 Cal.2d 427, 116 P.2d 37.....	13
Engelberg v. Local Union No. 12 of Int. U. of Operating Eng. (9th Cir. 1962) 300 F.2d 785.....	11, 21, 38



	Pages
Empire Dist. Electric Co. v. Rupert (8th Cir. 1952) 199 F.2d 941, cert. denied, 345 U.S. 909, 73 S.Ct. 649, 97 L. Ed. 1344 .....	9
Englander Motors, Inc. v. Ford Motor Company (6th Cir. 1961) 293 F.2d 802.....	40
Farris v. San Diego Federal Savings & Loan Association (S.D. Cal. 1956) 140 F.Supp. 703.....	40
Flaherty v. McDonald (S.D. Cal. 1960) 183 F.Supp. 300..	12
Gart v. Cole (2nd Cir. 1959) 263 F.2d 244, cert. denied, 359 U.S. 978, 79 S.Ct. 898, 3 L.Ed.2d 929.....	17
Goldberg v. International Testing Corporation (S.D. Cal. 1962) 30 F.R.D. 367.....	21
Golden Gate Scenic Steamship Lines, Inc. v. Public Utilities Com. (Sup. Ct. Cal. 1962) 57 Cal.2d 373, 369 P.2d 257..	20
Highway Truck Drivers & Helpers, Etc. v. Cohen (3rd Cir. 1960) 284 F.2d 162, cert. denied, 365 U.S. 833, 81 S.Ct. 747, 5 L.Ed.2d 744 .....	11
Highway Truck Drivers and Helpers Local 107 v. Cohen (E.D. Pa. 1960) 182 F.Supp. 608.....	12, 22
Holton v. McFarland (D. Alaska 1963) 215 F.Supp. 372...	12, 22
Hudson Distributors v. Eli Lilly, 377 U.S. 386, 84 S.Ct. 1273, 12 L.Ed.2d 394.....	4, 15
In Re Dayton Coal & Iron Co. (E.D. Tenn. 1922) 291 Fed. 390 .....	18
In Re Marble (Sup. Ct. Me. 1938) 136 Me. 52, 1 A.2d 355	30
Jaffke v. Dunham, 352 U.S. 280, 77 S.Ct. 307, 1 L.Ed.2d 314, cert. denied, 355 U.S. 835, 78 S.Ct. 55, 2 L.Ed.2d 46	8, 9
Jernigan v. Southern Pacific Company (9th Cir. 1955) 222 F.2d 245 .....	9
Levy v. Paramount Pictures (N.D. Cal. 1952) 104 F.Supp. 787 .....	40
Los Angeles Jr. D. & M. Exch. v. Securities & Exch. Com'n, (9th Cir. 1960) 285 F.2d 162, cert. denied, 366 U.S. 919, 81 S.Ct. 1095, 6 L.Ed.2d 241.....	10
Ma Chuck Moon v. Dulles (9th Cir. 1956) 237 F.2d 241, cert. denied, 352 U.S. 1002, 77 S.Ct. 559, 1 L.Ed.2d 547	1

## TABLE OF AUTHORITIES CITED

v

	Pages
McClaine v. Rankin, 197 U.S. 154, 25 S.Ct. 410, 49 L.Ed. 702 .....	39
Mercantile National Bank v. Langdean, 371 U.S. 555, 83 S. Ct. 520, 9 L.Ed.2d 523.....	15
Montgomery v. Equitable Life Assur. Soc. (7th Cir. 1936) 83 F.2d 758 .....	18
Pacific Portland Cement Co. v. Food Mach. & Chem. Corp. (9th Cir. 1949) 178 F.2d 541.....	21
Penueles v. Moreno (S.D. Cal. 1961) 198 F.Supp. 441....	22, 37
Perscio v. Daley (S.D.N.Y. 1965) 239 F.Supp. 629.....	23, 24
Petition of J. E. Brenneman Company (3rd Cir. 1963) 322 F.2d 846 .....	11
Petray v. First Nat. Bank (D.C.A. Cal. 1928) 92 Cal.App. 86, 267 Pac. 711.....	30
Phillips v. Sanger Lumber Co. (Sup. Ct. Cal. 1900) 130 Cal. 431, 62 Pac. 749.....	30
Santa Cruz, etc. Cement Co. v. Young (D.C.A. Cal. 1943) 56 Cal.App.2d 504, 133 P.2d 32.....	13
Schatte v. International Alliance, Etc. (S.D. Cal. 1949) 84 F.Supp. 669, affd., 182 F.2d 158, rehearing denied, 183 F.2d 685, cert. denied, 340 U.S. 827, 71 S.Ct. 64, 95 L.Ed. 608, rehearing denied, 340 U.S. 885, 71 S.Ct. 194, 95 L. Ed. 643 .....	17
Shivel v. Hurd (D.C.A. Cal. 1954) 129 Cal.App.2d 320, 276 P.2d 895 .....	21
Smith v. General Truck Drivers, Etc. Union Local 467 (S.D. Cal. 1960) 181 F.Supp. 14.....	12, 13
Sovereign Camp. v. Bolin, 305 U.S. 66, 59 S.Ct. 35, 83 L. Ed. 45 .....	17
Town of South Tucson v. Tucson Gas, Electric & Pow. Co. (9th Cir. 1945) 149 F.2d 847.....	9
Wimann v. Sunset-McKee Company (9th Cir. 1955) 221 F. 2d 128 .....	25
United States v. Moser, 266 U.S. 236, 45 S.Ct. 66, 69 L.Ed. 262 .....	16
United States v. Munsingwear, Inc., 340 U.S. 36, 71 S.Ct. 104, 95 L.Ed. 36.....	18, 19

	Pages
Williamson v. Columbia Gas & Electric Corporation, 91 F. Supp. 874, affd., 186 F.2d 464, cert. denied 341 U.S. 921, 71 S.Ct. 743, 95 L.Ed. 1355.....	15, 17
Wilbur's Estate (Sup. Ct. Pa. 1938) 334 Pa. 45, 5 A.2d 363	30

### Codes

California Code of Civil Procedure, Section 338(1) .....	40
--	----

### Rules

Federal Rules of Civil Procedure:	
Rule 23(b) .....	8, 41, 42
Rule 41(b) .....	10
Rule 52(a) .....	10

### Statutes

Labor Management Reporting and Disclosure Act of 1959 (73 Stat. 519 et seq., 29 U.S.C. Section 401 et seq.): ....	21
Section 501 .....	20, 21, 23
Section 501(b) .....	7, 10, 22, 37

### Texts

Bogert, Trusts and Trustees, Section 942 .....	30
Prentice Hall Pension and Profit Sharing Reporter, ¶2035	28

No. 20,120

# United States Court of Appeals

## For the Ninth Circuit

---

LOUIS HORNER, JOHN L. CONNOLLY, VICTOR ROMERO, JAMES RIEMERS, and HUGH BELL for the benefit of THE PACIFIC COAST DISTRICT OF NATIONAL MARINE ENGINEERS' BENEFICIAL ASSOCIATION, an unincorporated association,

*Appellants,*

vs.

V. A. FERRON, HENRY A. BORELLO, W. H. BUTTRAM, ROBERT H. HORNE, C. W. JENKINS, HARRY LEWIS, R. H. ROBINSON, F. E. WALTON, C. BLACK, H. COLEMAN, S. R. FRANKS, GEORGE B. SALOVICH, FRODE ANDERSEN, FRANCIS H. ROGERS, CHEMICAL BANK NEW YORK TRUST COMPANY, a New York corporation, and FIRST DOE through TENTH DOE, inclusive,

*Appellees.*

Appeal from an Order Denying Application and Motion to File Complaint, of the United States District Court for the Northern District of California, Southern Division  
Honorable George B. Harris, Chief Judge

**BRIEF FOR APPELLEES**

**STATEMENT OF THE CASE****A****Statement of Facts**

This is an appeal from an order of the United States District Court, Northern District of California, Southern Division (Harris, Chief Judge) denying appellants' application and motion to file a complaint under the Labor Management Reporting and Disclosure Act of 1959, 73 Stat. 519 *et seq.*, 29 U.S.C. §401 *et seq.* (hereinafter referred to as LMRDA). The order was entered after two hearings were held in the District Court, at which witnesses were examined, upon affidavits, and the record in Action No. 41678, pending before the same District Judge in the District Court. (R.T. March 31, 1965; R.T. April 15, 1965; C.T. 76, 79, 112. The record in Action No. 41678 was before the District Court and referred to by the parties in argument, affidavit and memoranda, e.g., R.T. March 31, 1965, pp. 2, 8; C.T. 77, 100, 101, 102, 104, 128, 129.)

On May 1, 1959 the National Marine Engineers' Beneficial Association and certain of its subordinate associations, including Association No. 97 (hereinafter referred to as Local 97) entered into a trust agreement with the Chemical Corn Exchange Bank, a New York corporation, to provide for a retirement and severance program for union officials known as the "MEBA Retirement and Severance Plan." (C.T. 1K, 16.) On April 1, 1962, Local 97 was merged with other local labor organizations on the Pacific Coast to form an organization known as the Pacific Coast District

of the National Marine Engineers' Beneficial Association (hereinafter referred to as the District). (R.T. March 31, 1965, pp. 28-29.) The referendum under which the District was formed provided that it would assume all the obligations of the individual locals. One of the obligations assumed was that of Local 97 to contribute to the MEBA Retirement and Severance Plan. (R.T. March 31, 1965, pp. 30-31.) The payments made to the plan are posted quarterly as part of the District's financial report, which is subject to the approval of members of District. (R.T. March 31, 1965, p. 31.)

On August 6, 1963, three of the five appellants herein (Louis Horner, John L. Connolly and Victor Romero) filed Action No. 41678 in the District Court. (C.T. 76, 99; compare captions C.T. 21, 65.) The original complaint in Action No. 41678 was permitted to be filed *ex parte* without an opportunity afforded to the named defendants to be heard in opposition to its filing. (Supp. C.T., memorandum of points and authorities attached to appearance of the Pacific Coast District, etc., p. 10.) On December 5, 1963, the plaintiffs in Action No. 41678 filed a motion for leave to file an amended complaint. (Supp. C.T., Notice of Motion, pp. 1 *et seq.*) The purpose of the proposed amended complaint was to add two additional defendants to that action namely: the District and the National Marine Engineers' Beneficial Association.<sup>1</sup> The

---

<sup>1</sup>The complaint and the proposed amended complaint in Action No. 41678 also named four of the appellees herein (W. A. Ferron, Henry A. Borello, Robert H. Horne and George B. Malovich).



allegations in the proposed amended complaint in Action No. 41678 were identical in substance to those in the proffered complaint which the District Court denied leave to file in this action. (R.T. March 31, 1965, p. 8; compare C.T. 65, *et seq. with* Supp. C.T. First Amended Complaint attached to Notice of Motion in Action No. 41678.) The District appeared in Action No. 41678 to oppose filing of the amended complaint. (Supp. C.T., Appearance of Pacific Coast District, etc.) On December 20, 1963, after argument and briefs, the District Court entered an order denying the motion requesting leave to file the amended complaint. (C.T. 64-a.) No appeal was taken from that order.

On March 31, 1965, appellants sought leave to file the complaint here under consideration. (C.T. 74; R.T., March 31, 1965.) The only significant difference, with respect to the District, between the proposed amended complaint in Action No. 41678 and the proposed complaint in this action is that in Action No. 41678 the District was named as a defendant and the complaint proposed herein purports to be for the benefit of the District as a plaintiff. An affidavit was filed in behalf of the District opposing the motion for leave to file the complaint herein. (C.T. 79.) A memorandum of points and authorities was also filed opposing the motion. (C.T. 99.) As indicated, two hearings were held on the motion where argument was made and testimony taken.

The evidence indicated that appellant Horner, the only person to verify the proposed complaint, was no

a member in good standing of the District at the time appellants sought leave to file it. (R.T., April 15, 1965, pp. 5-10.) There was evidence that Horner was a pensioner and not an active seaman; that appellant Romero was a real estate salesman and had not been to sea since 1954; that appellant Riemers was retired on social security and that appellant Bell was the only active seaman among appellants. (R.T., March 31, 1965, pp. 49-50.) The record also indicated that, even assuming for the sake of argument only, the MEBA Retirement and Severance Plan was improperly adopted, the plan was ratified by the membership of District. (R.T., March 31, 1965, pp. 15-17, 30-31; Exhibits A, B, C, D, E, F, G attached to affidavit of Wesley A. Ferron, C.T. 80.) The record also discloses that internal union remedies are available to appellants in connection with the issues they seek to raise in the proposed complaint. (C.T. 138.) The National MEBA Constitution is attached to the affidavit of W. A. Ferron in Supp. C.T. as well as a copy of District's By-Laws. The By-Laws are also found in Exhibit H attached to the affidavit of Wesley A. Ferron. See also R.T., March 31, 1965, p. 43.)

## B

### Preliminary Comments

Nowhere do appellants claim that it was beyond the power of the District (*ultra vires*) to adopt and participate in the MEBA Retirement and Severance Plan. Nor do appellants contend that even if the plan were improperly adopted, it could not have been

or could not be ratified at any time by the members of the District.

Appellees, including the District, take the position in Action No. 41678 and in this action that the MEBA Retirement and Severance Plan was duly authorized by the District's predecessor, Local 97. (E.g., Supp. C.T., Affidavit of W. A. Ferron, etc., p. 2.) The statement at page 20 of Appellants' Brief that "Appellees did not dispute that the Plan was initially unauthorized . . ." is not correct. The District Court had before it the record in Action No. 41678. Appellees referred to this record in the Memorandum of Points and Authorities opposing the filing of the proposed complaint herein. (C.T. 99, 100, 101, 102.) After so referring to Action No. 41678, and seeing no need to repeat the arguments and affidavits there presented, appellees took the further position that "*Therefore, even assuming for the purpose of this hearing that the original authorization of the union membership for the severance pay plan was in some way faulty, said plan has been ratified, affirmed and adopted by the full union membership in accordance with democratic procedures.*" (Emphasis added; C.T. 103.) Appellees then produced evidence on the question of ratification, most of which had not been before the Court in Action No. 41678.)

The resolution under which the MEBA Retirement and Severance Plan for MEBA officials was adopted, and the plan itself, provide for a contributory plan; in addition to the union, contributions are required from and paid by each of the officials covered under

the plan. (C.T. 2-3, 29.) On the other hand, the Pacific Maritime Association Pension agreement, under which MEBA members are covered, is a non-contributory plan for which the members pay nothing at all for their pension benefits. (C.T. 31 *et seq.*) If a District official is eligible for both the MEBA Retirement and Severance Plan and the PMA Plan, he must choose one, as the District will only make a payment to one Plan. (R.T., March 31, 1965, pp. 46-48.)

---

## ARGUMENT

### I

#### SUMMARY OF THE ARGUMENT

Appellees contend that the order of the District Court denying leave to file the proposed complaint under Section 501(b) of LMRDA should be affirmed because the statute is not retroactive and therefore the District Court lacked jurisdiction to entertain a proposed complaint dealing with matters which occurred prior to the enactment of LMRDA. The order should also be affirmed because appellants were precluded from bringing the proposed action by reason of a final adverse determination on the same subject matter in Action No. 41678 in the District Court.

In addition, the order should be affirmed because the question of whether good cause existed to permit filing of the proposed complaint was duly considered and decided adversely to appellants in the sound discretion of the District Court. In this connection and

along with the grounds heretofore stated, the record sustains the valid exercise of the District Court's discretion, since it was demonstrated below that (1) The appellant Horner who verified the proposed complaint was not a member in good standing of the District—he had no standing to sue and no proper verified complaint was before the Court; (2) The MEBA Retirement and Severance Plan was properly adopted; (3) Even if it be assumed, *arguendo*, that the MEBA Retirement and Severance Plan was not properly adopted initially, it was duly ratified by the members of District; (4) Appellants did not exhaust their internal union remedies; (5) The proposed complaint is stale and barred by the statute of limitations; and (6) Appellants did not comply with Rule 23(b) of the Federal Rules of Civil Procedure.

---

## II

### GENERAL RULES GOVERNING THIS APPEAL

- a. **If There Is Anything in the Record to Sustain the Order of the District Court, It Must Be Affirmed on Appeal.**

If there is anything in the record to sustain the order of the District Court denying permission to file the proposed complaint, the order must be affirmed on appeal.

“A successful party in the District Court may sustain its judgment on any ground that finds support in the record.” (*Jaffke v. Dunham*, 352 U.S. 280, 281, 77 S.Ct. 307, 308, 1 L.Ed.2d 314,



cert. denied, 355 U.S. 835, 78 S.Ct. 55, 2 L.Ed.2d 46.)

*Town of South Tucson v. Tucson Gas, Electric & Pow. Co.* (9th Cir. 1945) 149 F.2d 847, 847-48;

*Aetna Insurance Company v. Eisenberg* (8th Cir. 1961) 294 F.2d 301, 308.

**b. The Burden of Showing Grounds Why the Order Appealed From Should Be Reversed Is on Appellants.**

Appellants have the burden on appeal of showing grounds why the District Court's order denying leave to file the proffered complaint should be reversed.

"The rule in the federal courts is that the burden of showing grounds on which a judgment should be reversed rests on the appellant." (*Empire Dist. Electric Co. v. Rupert* (8th Cir. 1952) 199 F.2d 941, cert. denied, 345 U.S. 909, 73 S.Ct. 649, 97 L.Ed. 1344.)

*Jernigan v. Southern Pacific Company* (9th Cir. 1955) 222 F.2d 245;

*Calhoun v. Bernard* (9th Cir. 1964) 333 F.2d 739, 741.

**c. The Question of Permitting Filing of the Proposed Complaint Was Addressed to the Sound Discretion of the Trial Court.**

The order from which appellants appeal is one which denied their motion to file a complaint under the LMRDA. (C.T. 64-a.) Findings of fact and conclusions of law were not made or necessary upon the entry of the order.



“ . . . Findings of fact and conclusions of law are unnecessary on decisions of motions under Rules 12 or 56 or any other motion except as provided in Rule 41(b).” (Fed. Rules Civ. Proc., Rule 52(a).)

The question of whether to permit the complaint to be filed was one addressed to the discretion of the District Court. (LMRDA §501(b).) If there is any basis upon which the District Court’s exercise of discretion can be sustained, the order appealed from herein must be affirmed.

“And in passing upon whether the trial court acted within its judicial discretion, we must interpret every intendment in favor of the legality of the court’s action.” (*Los Angeles Jr. D. & M. Exch. v. Securities & Exch. Com’n* (9th Cir. 1960) 285 F.2d 162, cert. denied, 366 U.S. 919, 81 S.Ct. 1095, 6 L.Ed.2d 241.)

“In a second sense, and the one most commonly meant in the use of the word in the law, ‘discretion’ is defined as: ‘The power exercised by courts to determine questions to which no strict rule of law is applicable but which, from their nature, and the circumstances of the case, are controlled by the personal judgment of the court. 1 Bouv. Law Dict., Rawles’ Third Revision, p. 884. Judicial action—discretionary in that sense—is said to be final and cannot be set aside on an appeal except when there is an abuse of discretion. . . . If reasonable men could differ as to the propriety of the action taken by the trial court, then it cannot be said that the trial court abused its discretion.” (*Delno v. Market St. Ry. Co.* (9th Cir. 1942) 124 F.2d 965, 967.)

See also,

*Edsberg v. Local Union No. 12 of Int. U. of Operating Eng.* (9th Cir. 1962) 300 F.2d 785;

*Highway Truck Drivers & Helpers, Etc. v. Cohen* (3rd Cir. 1960) 284 F.2d 162, cert. denied 365 U.S. 833, 81 S.Ct. 747, 5 L.Ed. 2d 744.

**d. The Evaluation of Credibility of Witnesses, in the Exercise of Discretion, Was for the Trial Court.**

As indicated, the District Court heard testimony before exercising its discretion on appellants' motion for leave to file the proposed complaint. Insofar as the order here under consideration rests upon conflicting testimony or the credibility of witnesses it is unassailable.

*Adamson v. Gilliland*, 242 U.S. 350, 353, 37 S. Ct. 169, 170, 61 L.Ed. 356, 357-358;

*Broadcast Music v. Havana Madrid Restaurant Corp.* (2nd Cir. 1949) 175 F.2d 77, 80;

*Petition of J. E. Brenneman Company* (3rd Cir. 1963) 322 F.2d 846, 852.

**e. Federal Courts, Under LMDRA, Should Not Intervene in Every Intra-Union Dispute.**

"The federal courts, of limited jurisdiction, cannot and should not intervene in any and every intra-union dispute."

(*Edsberg v. Local Union No. 12 of Int. U. of Operating Eng.* (9th Cir. 1962) 300 F.2d 785, 788.)

## III

## THE DISTRICT COURT PROPERLY DENIED APPELLANTS' APPLICATION AND MOTION TO FILE COMPLAINT BECAUSE OF LACK OF JURISDICTION

Appellants sought to file this action under authority of the LMRDA. It is undisputed that the MEBA Retirement and Severance Plan was established on May 1, 1959. (C.T. 1K, 67.) The LMRDA became effective on September 14, 1959. The provisions of the LMRDA are not retroactive. (*Smith v. General Truck Drivers, Etc., Union Local 467* (S.D. Cal. 1960) 181 F.Supp. 14, 18; *Flaherty v. McDonald* (S.D. Cal. 1960) 183 F.Supp. 300, 304; *Highway Truck Drivers and Helpers Local 107 v. Cohen* (E.D. Pa. 1960) 182 F.Supp. 608, 611; *Holton v. McFarland* (D. Alaska 1963) 215 F.Supp. 372, 376.) The complaint sought to be filed by appellants is an attempt to attack a plan which was in existence prior to the time LMRDA became effective. The allegations relating to contributions which have periodically been made to the plan since April 15, 1962 are based upon the premise that the agreement of May 1, 1959, which established the plan, was not properly authorized. (C.T. 67.) All the events relating to the adoption of the MEBA Retirement and Severance Plan occurred on or before May 1, 1959. If the plan were improperly adopted the cause of action accrued on that date. (*Conlin v. United States* (Ct. Cl. 1956) 146 F.Supp. 833, 835, cert. den. 353 U.S. 916, 77 S.Ct. 663, 1 L.Ed.2d 663.) It has been held that in the case of pension plans that rights dealing with periodic payments are continuing ones only after the basic right has been established.

“... Before plaintiff can claim these periodic payments, however, she must establish her right to a pension. . . . An action to determine the existence of the right thus necessarily precedes and is distinct from an action to recover installments which have fallen due after the pension has become granted.

“A cause of action accrues when a suit may be maintained thereon. . . .” (*Dillon v. Board of Pension Commrs.* (Sup. Ct. Calif. 1941) 18 Cal. 2d 427, 430, 116 P.2d 37; 39.)

See also,

*Santa Cruz, etc. Cement Co. v. Young* (D.C.A. Calif. 1943) 56 Cal.App.2d 504, 507, 133 P. 2d 32, 33.

These allegations in the proposed complaint refer back to the original act of adopting the plan, and the District Court had no jurisdiction to inquire into the plan which was in effect prior to the LMRDA. (*Smith v. General Truck Drivers, Etc., Union Local 467, supra*, 181 F.Supp. 14, 18.) The District Court properly denied appellants' application and motion to file the complaint because it lacked jurisdiction over the subject matter of the proposed complaint.

---

#### IV

#### THE DISTRICT COURT PROPERLY DENIED APPELLANTS' APPLICATION AND MOTION TO FILE COMPLAINT UNDER THE DOCTRINE OF RES JUDICATA OR COLLATERAL ESTOPPEL

On August 6, 1963 three of the five appellants herein (Louis Horner, John L. Connolly and Victor Romero) filed Action No. 41678 in the District Court.

On December 4, 1963, the plaintiffs in Action No. 41678 filed a motion for leave to file an amended complaint. The purpose of the proposed amended complaint was to add two additional defendants to that action namely: The District and the National Marine Engineers' Beneficial Association. The proposed amended complaint in Action No. 41678 named four of the appellees herein (W. A. Ferron, Henry A. Borello, Robert H. Horne and George B. Salovich) and the District as defendants. The allegations in the proposed amended complaint in Action No. 41678 were identical in substance to those in the complaint in this action which the District Court denied leave to file. (Compare Supp. C.T., First Amended Complaint attached to Notice of Motion in Action No. 41678 *with* C.T. 65 *et seq.*) The District appeared specially in Action No. 41678 to oppose filing of the amended complaint. On December 20, 1963 the District Court entered an order denying the motion requesting leave to file the amended complaint. No appeal was taken from that order. On March 31, 1965 appellants sought leave to file the complaint here under consideration. The only significant difference, with respect to District, between the proposed amended complaint in Action No. 41678 and the complaint proposed in this action is that in Action No. 41678 District was named as a defendant and the complaint proposed herein purports to be for the benefit of the District as a plaintiff.

Appellees opposed the motion for leave to file the proposed complaint on the ground, among others, that



it was barred by the final ruling of the District Court in Action No. 41678 denying leave to file the proposed amended complaint in that action.<sup>2</sup> (R.T. March 31, 1965, pp. 2-5; C.T. 100.)

The denial of the motion to file the amended complaint in Action No. 41678 was, as to the District, an adjudication on the merits that the plaintiffs were not entitled to any relief against District under the proffered allegations respecting the MEBA Retirement and Severance Plan. (*Angel v. Bullington*, 330 U.S. 183, 190, 67 S.Ct. 657, 661, 91 L.Ed 832, 837; *Williamson v. Columbia Gas & Electric Corporation*, 91 F.Supp. 874, 877-78, affd. 186 F.2d 464, cert. denied 341 U.S. 921, 71 S.Ct. 743, 95 L.Ed. 1355.)

The order of the District Court in Action No. 41678 entered on December 20, 1963 was, as to District, a final, appealable order. (*Mercantile National Bank v. Langdean*, 371 U.S. 555, 83 S.Ct. 520, 9 L.Ed.2d 523; *Hudson Distributors v. Eli Lilly*, 377 U.S. 386, 389 fn. 4, 84 S.Ct. 1273, 1276 fn. 4, 12 L.Ed.2d 394, 397 fn. 4; *Chapman v. Sheridan-Wyoming Co.*, 338 U.S. 621, 70 S.Ct. 392, 94 L.Ed. 393.) No appeal was taken from the order. It became res judicata as to the parties.

---

<sup>2</sup>There was some uncertainty at the time of the first hearing on the motion whether the proposed complaint was to be considered in Action No. 41678. "The Clerk: Horner and others v. The Marine Engineers Beneficial Association, No. 97, Inc.; and others. Motion for leave to file complaint." (R.T. March 31, 1965, p. 2.) At this juncture counsel for appellees referred to the previous final ruling as "law of the case". (R.T. March 31, 1965, p. 4; C.T. 100.) The record is clear that counsel for appellants understood appellees' contention that the proposed complaint was barred by a final adverse determination in prior litigation. (R.T. March 31, 1965, pp. 9-10, 12.)



Even if it be assumed, for the sake of argument only, that the order was incorrect, it would still be *res judicata*.

“... a fact, question or right distinctly adjudged in the original action cannot be disputed in a subsequent action, even though the determination was reached upon an erroneous view or by an erroneous application of the law.” (*United States v. Moser*, 266 U.S. 236, 242, 45 S.Ct. 66, 67, 69 L.Ed. 262, 264.)

“The remaining question is simply whether respondents, having failed to raise the question in the proceeding to which they were parties and in which they could have raised it and had it finally determined, were privileged to remain quiet and raise it in a subsequent suit. Such a view is contrary to the well-settled principle that *res judicata* may be pleaded as a bar, not only as respects matters actually presented to sustain or defeat the right asserted in the earlier proceeding, ‘but also as respects any other available matter which might have been presented to that end.’ (citations omitted)”

*Chicot County Dist. v. Bank*, 308 U.S. 371, 378, 60 Sup.Ct. 317, 320, 84 L.Ed. 329, 334-335.

In the present action appellants seek to avoid the doctrines of *res judicata* and collateral estoppel by the device of changing some of the parties plaintiff and, instead of bringing an action against the District, purporting to bring the action for the benefit of the District. However, a comparison of the proposed complaint in this action and the proposed amended complaint in Action No. 41678 clearly indicates that

as to the District the purpose of both was to challenge the District's participation in the MEBA Retirement and Severance Plan and, as indicated, *res judicata* would apply. (*Angel v. Bullington, supra*, 330 U.S. 183; *Williamson v. Columbia Gas & Electric Corporation, supra*, 91 F.Supp. 874.) The changing of certain plaintiffs does not alter the application of the doctrine. The proposed amended complaint in Action No. 41678 was verified only by appellant Horner. (Supp. C.T., Complaint attached to Notice of Motion, p. 9.) The primary material offered in support of the proposed amended complaint in Action No. 41678 was the affidavit of appellant Horner. The only material offered in support of the proposed complaint in this action was the declaration and affidavit of appellant Horner.<sup>3</sup> (C.T. 76, 112.) Appellants Horner, Connolly and Romero who were parties in Action No. 41678 are directly subject to the principles of *res judicata* as heretofore indicated. Appellant Horner was the only appellant to verify the complaint. In the circumstances appellants Riemers and Bell are in privity with Horner and bound by the principles of *res judicata* or collateral estoppel. (*Sovereign Camp v. Bolin*, 305 U.S. 66, 78-79, 59 S.Ct. 35, 83 L.Ed. 45, 51-52; *Ma Chuck Moon v. Dulles* (9th Cir. 1956) 237 F.2d 241, cert. denied, 352 U.S. 1002, 77 S.Ct. 559, 1 L.Ed.2d 547; *Schatte v. International Alliance, Etc.* (S.D. Cal. 1949) 84 F.Supp. 669, *affd.*, 182 F.2d 158, rehearing

---

<sup>3</sup>Counsel for appellants filed a declaration, not dealing with the merits, with respect to appellants' *ex parte* request to file the proposed complaint. (C.T. 72.)

denied, 183 F.2d 685, cert. denied, 340 U.S. 827, 71 S.Ct. 64, 95 L.Ed. 608, rehearing denied, 340 U.S. 885, 71 S.Ct. 194, 95 L.Ed. 643; *Gart v. Cole* (2nd Cir. 1959) 263 F.2d 244, cert. denied 359 U.S. 978, 79 S.Ct. 898, 3 L.Ed.2d 929; *Montgomery v. Equitable Life Assur. Soc.* (7th Cir. 1936) 83 F.2d 758; *In Re Dayton Coal & Iron Co.* (E.D. Tenn. 1922) 291 Fed. 390.)

This case is analogous to *United States v. Munsingwear, Inc.*, 340 U.S. 36, 71 S.Ct. 104, 95 L.Ed. 36. In *Munsingwear*, the United States sued the respondent for alleged violations of a price fixing regulation, seeking, in separate counts, (1) an injunction and (2) treble damages. By agreement, the second count was held in abeyance pending trial and final determination of the suit for an injunction. The District Court dismissed the complaint holding that respondent's prices complied with the regulation. While an appeal was pending the commodity involved was decontrolled. Respondent moved to dismiss the appeal on the ground of mootness and the Court of Appeals granted the motion and dismissed it on that ground. The United States acquiesced in the dismissal. Respondent then moved in the District Court to dismiss the treble damage actions on the ground that the unreversed judgment of the District Court in the injunction suit was res judicata of those other actions. The District Court granted the motion and dismissed the treble damage actions. The Court of Appeals affirmed the judgment. The Supreme Court in affirming the judgment stated:

“. . . If there is hardship in this case, it was preventable. The established practice of the Court

in dealing with a civil case from a court in the federal system which has become moot while on its way here or pending our decision on the merits is to reverse or vacate the judgment below and remand with a direction to dismiss. That was said in *Duke Power Co. v. Greenwood County*, 299 U.S. 259, 267, to be 'the duty of the appellate court.' That procedure clears the path for future relitigation of the issues between the parties and eliminates a judgment, review of which was prevented by happenstance. When that procedure is followed, the rights of all parties are preserved; none is prejudiced by a decision which in the statutory scheme was only preliminary.

"In this case the United States made no motion to vacate the judgment. It acquiesced in the dismissal. It did not avail itself of the remedy it had to preserve its rights. . . .

"The case is therefore one where the United States, having slept on its rights, now asks us to do what by orderly procedure it could have done for itself. The case illustrates not the hardship of *res judicata* but the need for it in providing terminal points for litigation." (*United States v. Munsingwear*, 340 U.S. 36, 39-41, 71 S.Ct. 104, 106-107, 95 L.Ed. 36, 41-42.)

Since appellants could have appealed from the denial of the motion to file the amended complaint in Action No. 41678 and they did not do so, the District Court properly denied the motion to file the complaint proffered herein because the previous order was *res judicata* on the issue that appellants were not entitled to any relief with respect to the District on the allega-

tions respecting the MEBA Retirement and Severance Plan.

---

## V

THERE WAS EVIDENCE FROM WHICH THE DISTRICT COURT, IN ITS DISCRETION, MUST BE ASSUMED TO HAVE FOUND THAT GOOD CAUSE DID NOT EXIST FOR PERMITTING THE FILING OF THE PROFFERED COMPLAINT.

### a. Applicable Law.

As indicated, the District Court was not required to file findings and conclusions in entering the order appealed from herein. Therefore, if there is anything in the record to sustain the exercise of discretion by the District Court, the order appealed from must be sustained. (See Section II, *supra*.) Appellants sought to file the proffered complaint under Section 501 of the LMRDA. (C.T. 65.) That section provides in part that: "No such proceeding shall be brought except upon leave of the Court obtained upon verified application and for good cause shown, which application may be made *ex parte*." The requirement for showing good cause is in addition to that requiring a verified application. If this were not so the language requiring a showing of good cause would be surplusage.

"It cannot be assumed that the Legislature intended the words . . . [and for good cause shown] to be merely 'surplusage, or . . . a repetition of a provision already made' in the statute." (*Golden Gate Scenic Steamship Lines, Inc. v. Public Utilities Com.* (Sup. Ct. Cal. 1962) 57 Cal.2d 373, 377, 369 P.2d 257, 260.)



“In construing the statute it should be in such a manner that ‘ “if it can be prevented, no clause, sentence, or word shall be superfluous, void or insignificant.” ’ (citations omitted)” (*Consolidated Flowers Ship. v. Civil Aeronautics Bd.* (9th Cir. 1953) 205 F.2d 449, 450.)

Appellants had the burden of establishing good cause for the filing of the complaint. (*Pacific Portland Cement Co. v. Food Mach. & Chem. Corp.* (9th Cir. 1949) 178 F.2d 541, 547; *Shivel v. Hurd* (D.C.A. Cal. 1954) 129 Cal.App.2d 320, 324, 276 P.2d 895, 898; *Goldberg v. International Testing Corporation* (S.D. Cal. 1962) 30 F.R.D. 367, 368.) The District Court in determining whether, in its discretion, appellants had established good cause for filing the proposed complaint was required to consider the rule that “The federal courts, of limited jurisdiction, cannot and should not intervene in any and every intra-union dispute.” (*Edsberg v. Local Union No. 12 of Int. U. of Operating Eng.* (9th Cir. 1962) 300 F.2d 785, 788.)

While Section 501 of LMRDA provides that an application for leave to file a complaint for good cause may be made *ex parte*, it has been held that:

“The showing of *good cause* may be made *ex parte*. By hornbook law any order made *ex parte* may be set aside either *ex parte* or on motion.

“The court concludes that no good cause has been shown and that the *ex parte* order should not have been issued. After our experience with this case, we think the better practice will be to require an adversary proceeding before permitting an action under Sec. 501(b) to be filed.”



(*Penuelas v. Moreno* (S.D. Cal. 1961) 198 F.Supp. 441.)

Where courts have permitted ex parte filing of complaints, the question of good cause has been considered in adversary proceedings on motions to dismiss. (*Holton v. McFarland* (D. Alaska 1963) 215 F.Supp. 372; *Smith v. General Truck Drivers, Etc. Union Local 467* (S.D. Cal. 1960) 181 F.Supp. 14.) In any event, an adversary proceeding was held in this action. In making its order the District Court could look not only to the proposed complaint verified by appellant Horner and affidavit and declaration of Horner, but could consider the weight to be given these documents after hearing and observing Horner on the witness stand and assessing his credibility. In addition, the District Court had before it the file in Action No. 41678 together with testimony, documentary evidence and affidavits presented by appellees. The District Court exercised its discretion in determining whether good cause existed by looking to the whole record. To hold otherwise would eliminate, for practical purposes, the good cause requirement of Section 501(b) and create federal jurisdiction requiring a trial on the merits every time a union member alleged a violation of duty by a union official. (Cf., *Highway Truck Drivers and Helpers Local 107 v. Cohen* (E.D. Pa. 1960) 182 F.Supp. 608, 615.)

**b. Facts From Which the District Court Found That Good Cause Was Not Established.**

1. **The Appellant Who Verified the Proposed Complaint and Filed Supporting Papers Was Not a Member in Good Standing of the District and Only One Alleged Plaintiff Was an Active Seaman.**

The only material offered on the merits to support the proposed complaint was the declaration and affidavit of appellant Louis Horner.<sup>4</sup> (C.T. 76, 112.) Horner was the only appellant to verify the complaint. (C.T. 70.) Section 501 of LMRDA provides for actions by a *member* of a labor organization. There was evidence that appellant Horner was not a member in good standing of District at the time appellants sought leave to file the proposed complaint. (R.T. April 15, 1965, pp. 5-10.) It must be assumed that the District Court found that he was not a member of District at the time leave to file the proposed complaint herein was sought. Since Horner was the only appellant to verify the complaint a proper verified complaint was not before the District Court. Also, since Horner's declaration and affidavit were the only items offered by appellants to show good cause in support of the proposed complaint, the District Court did, in its discretion, find that good cause had not been established. (See: *Perscio v. Daley* (S.D.N.Y. 1965) 239 F.Supp. 629.)

Furthermore, even if it be assumed, for argument only, that Horner was a member of the District when

---

<sup>4</sup>Counsel for appellants filed a declaration, not dealing with the merits, with respect to appellants' ex parte request to file the proposed complaint. (C.T. 72.)

leave was sought to file the complaint, the record shows that he was a pensioner and not an active seaman; that appellant Romero was a real estate salesman and had not been to sea since 1954; that appellant Connolly was a pensioner; that appellant Riemers was retired on social security and that appellant Bell was the only active seaman among appellants. (R.T. March 31, 1965, pp. 49-50.) Furthermore, the record indicates that appellant Bell did not make any prior demand requesting union action with respect to this matter. (Exhibits C, D, E, F and G attached to affidavit of Wesley A. Ferron, C.T. 80.) Therefore, Bell is not a proper party plaintiff in the proposed complaint. (*Perscio v. Daley, supra.*) In these circumstances the District Court could conclude that good cause was not shown for these appellants to file the proposed complaint.

## **2. The MEBA Retirement and Severance Plan Was Properly Adopted.**

Appellants attack the MEBA Retirement and Severance Plan on the ground that it was entered into on May 1, 1959 without any valid authorization. (C.T. 67.) Horner's affidavit in Action No. 41678 indicates the passage of Resolution No. 327 by Local 97 on July 5, 1957. (C.T. 24.) A copy of Resolution 327 was attached. (C.T. 29.) It is appellants' contention that since the resolution uses the words "retirement program" the *severance* portion of the MEBA Retirement and Pension Plan was not authorized. However, the District Court could properly conclude, from

modern common experience, that the terms "retirement program" and "retirement plan" encompassed the severance portion of the plan.

"From modern common experience, it is known that one pension plan may take care of the pensioner himself. Another plan specifically takes care of the pensioner's widow or perhaps minor children in addition to the pensioner." (*Ulmann v. Sunset-McKee Company* (9th Cir. 1955) 221 F. 2d 128, 132.)

It is clear that modern retirement plans utilize severance provisions.

*"Qualified pension plan as means of providing dismissal payments.*—Most union contracts call for payment of dismissal wages if an employee should be discharged through no fault of his own. A qualified pension plan is a convenient way of budgeting for this contingency, although the plan must not be *primarily* a dismissal-wage scheme, or it will not qualify under §401(a).

Unions today regard dismissal wage payments as a proper and recognized condition of employment, hence a valid subject of collective bargaining. The basic premise is that while an employee may not have a vested interest in his job, he may have a substantial expectancy in it. The right to dismissal wages is therefore claimed to be based upon the employer's implied promise to continue employment so long as duties are discharged satisfactorily.

*Reserve is impractical.*—Yet the need for paying dismissal wages may arise at the exact time

when the employer can least afford to pay them. Of course, he could establish an accounting reserve for payment of dismissal wages. In most cases, however, this would be unwise because it would tie up working capital against an event that might never occur. Moreover, the reserve would consist of 'net after tax' funds, since amounts allocated to it would not be deductible for income tax purposes.

*Advantages of qualified plan.*—In addition to the main benefits accruing to management and employee under any qualified plan, one providing severance benefits upon involuntary dismissal for reasons other than an employee's dishonesty, etc., possesses these obvious advantages:

(1) Funds accumulated primarily against an employee's retirement or death are instantly available for legal diversion at the earlier occurrence of forced termination of employment.

(2) Funds are not segregated solely to provide dismissal wages but to hedge three contingencies—forced severance, retirement, death—one of which is bound to occur unless an employee should leave of his own accord or be discharged for cause.

(3) The employer's expense is reduced because:

(a) his contributions are deductible from gross income in the year made, within the limitations provided in §404(a), and

(b) the fund is swelled by its own earnings, which are tax-exempt under §401(a).

*Lump-sum payments.*—Unions favor lump-sum severance benefits from a qualified trust not only because they cushion the shock of unemployment



but also because they get long-term capital gain treatment. This means that normally a terminated employee will include only half of the benefit in his gross income.

*Illustrative provision.*—The B. F. Goodrich Company added a severance benefit provision to its pension plan and got Treasury approval. Here is how the Goodrich provision works:

To be eligible for a termination payment, an employee must have at least five years of continuous service credit. He must be ineligible for a pension and be released from employment (a) because he has reached his normal retirement date or (b) because he is physically or mentally unable to meet the requirements of his job and cannot qualify for transfer to another job. The severance payment is made in a lump sum.

The amount paid to an employee who has reached the normal retirement date is a sum equal to one and one-half weeks' pay for each year of continuous service credit (taken to completed twelfths). As for other terminated employees, their lump-sum payments depend on years of service according to the following schedule:

1. For an employee having five or more but less than ten completed years of continuous service credit—one week's pay for each year of continuous service credit.

2. For an employee having ten or more but less than fifteen completed years of continuous service credit—one and one-fourth weeks' pay for each year of continuous service credit.

3. For an employee having fifteen or more years of continuous service credit—one and one-



half weeks' pay for each year of continuous service credit.

If an employee who has not reached normal retirement date is entitled to any severance allowance provided by law, then the part of such allowance attributable to company contributions is deducted from the severance payment from the pension plan.

Severance payments according to the above schedule are also available to workers whose employment is terminated as the result of a plant shutdown, provided they are not otherwise entitled to pensions. An employee eligible for a deferred vested pension can get a severance payment if he makes an election in writing to receive the severance payment instead of the deferred vested pension."

(Prentice Hall Pension and Profit Sharing Reporter ¶2035.)

3. **Even If It Be Assumed, for the Sake of Argument Only, That the MEBA Retirement and Severance Plan Was Not Properly Adopted, the Plan Was Duly Ratified by the Members of the District.**

If it be assumed *arguendo* that the MEBA Retirement and Severance Plan was not properly adopted, it was duly ratified by the District membership. The doctrine of ratification was aptly stated by Lord Eldon:

"It is established by all the cases that if the *cestui que trust* joins with the trustees in that which is a breach of the trust, knowing the circumstances, such a *cestui que trust* can never complain of such breach of trust. I go further,

and agree that either concurrence in the act, or acquiescence without original concurrence, will release the trustees. . . ." (*Walker v. Symonds*, 3 Swanst. 2, 64.)

"After a breach of trust has occurred, a beneficiary may expressly or impliedly express satisfaction with the act and thereby prevent himself from claiming thereafter that it was illegal. This transaction is sometimes described by the name 'ratification,' or 'confirmation,' or 'acquiescence.' Its essence is that the beneficiary unequivocally declares that he does not regard the act in question as a breach of trust but rather elects to treat it as a lawful transaction under the trust. He has the election of disaffirming the transaction or of accepting it.

Ratification binds a successor trustee acting for the beneficiary in making a claim against a predecessor trustee, and also successors in ownership of the beneficiary's interest. A successor trustee may act for the beneficiary in ratifying an act of a predecessor trustee.

Ratification may occur by an express statement of the attitude of the beneficiary, as, for example, by a verbal statement to the trustee, or by an informal or written document delivered to the trustee, or ratification may be implied from the conduct of the cestui, as, for example, from the acceptance of the results or benefits from the act in question, without a claim that there had been a breach.

It would seem that there need be no consideration for ratification, although it sometimes does exist.

The doctrine of ratification is applied in the law of principal and agent, master and servant, and corporations. An otherwise unlawful or unauthorized act may be validated after it has been performed."

(Bogert, Trusts and Trustees, §942.)

*Phillips v. Sanger Lumber Co.* (Sup. Ct. Cal. 1900) 130 Cal. 431, 62 Pac. 749;

*Petray v. First Nat. Bank* (D.C.A. Cal. 1928) 92 Cal. App. 86, 267 Pac. 711;

*In re Marble* (Sup. Ct. Me. 1938) 136 Me. 52, 1 A.2d 355;

*Coulter Estate* (Sup. Ct. Pa. 1954) 379 Pa. 209, 218, 108 A.2d 681;

*Wilbur's Estate* (Sup. Ct. Pa. 1938) 334 Pa. 45, 55, 5 A.2d 363.

The District's by-laws provide that:

"A majority vote of the membership shall be authorization for any Union action, unless otherwise specified in the National Constitution or these By-Laws." (By-Laws of Pacific Coast Dist., Art. I, Exhibit H attached to Affidavit of Wesley A. Ferron, filed on March 31, 1965, C.T. 80, also found in Supp. C.T. attached to affidavit of Wesley A. Ferron.)

The District's by-laws also provide that:

"When applicable to the District as a whole, the term 'majority vote of the membership' shall mean the majority of all the valid votes cast by members at an official meeting of those branches holding a meeting. This definition shall prevail, notwithstanding that one or more Branches can-

not hold meetings because of no quorum.”<sup>5</sup> (By-Laws of Pacific Coast Dist., Art. XX, Sec. 3, Exhibit H attached to affidavit of Wesley A. Ferron, C.T. 80, also in Supp. C.T. attached to affidavit of Wesley A. Ferron.)

The District has branches in San Francisco, California; Seattle, Washington; Portland, Oregon; Wilmington, California and Honolulu, Hawaii. District Headquarters is in San Francisco. (By-Laws of Pacific Coast Dist., Art. III, Sec. 2, *supra*.) The minutes of the meeting of the District’s San Francisco Branch on February 11, 1965, indicate that 188 members were present and that the following occurred:

“Motion by V. Romero, seconded by L. Horner: ‘I move that the Pacific Coast District instructs its officers to file suit to recover the funds paid by the District to the M.E.B.A. Officers’ Retirement and Severance Plan on behalf of the various officers of the District. I so do move because these funds were paid into the Officers’ Retirement and Severance Plan as a result of violations by the Officers of fiduciary duties to the Union and its members under the law of California, and also under Section 501 (a) of the Federal Labor Management Reporting and Disclosure Act of 1959’. The Chair stated that the motion was simi-

---

<sup>5</sup>Appellants state, at page 20 of their opening brief, “Respecting the Branch votes, appellees failed to indicate below how a Branch vote could constitute ratification on behalf of the entire District.” This contention is not correct. The District’s By-Laws were before the District Court, and it is clear from the by-laws above-cited that when the District as a whole votes, it does so by Branches.

lar to the one presented a year previously. Vote on motion, 7 for, 95 against, motion lost.”

(Exhibit D attached to affidavit of Wesley A. Ferron, C.T. 80.)

A similar motion by Horner had been presented at the December 5, 1963 meeting of the San Francisco Branch and was defeated 59-21. (R.T. April 15, 1965, pp. 12-13; Exhibit C attached to Affidavit of Wesley A. Ferron, C.T. 80; Exhibit attached to Affidavit of W. A. Ferron, Supp. C.T.) Horner admitted that he was not in any way prevented from speaking on his motion in the open union meeting. (R.T. April 15, 1965, p. 13.)

The minutes of the District's Wilmington Branch for February 8, 1965 indicate that 60 members were present and that the following occurred:

“The Chair read a letter dated January 27, 1965 from Brother Louis Horner to the District Executive Committee of the M.E.B.A., Pacific Coast District, to take such action as may be necessary to recover all contributions paid by the District to the National M.E.B.A. Retirement and Severance Fund. Brother John Connolly read a prepared motion as follows:

‘I move that the Pacific Coast District instructs its officers to file suit to recover the funds paid by the District to the M.E.B.A. Officers' Retirement and Severance Plan on behalf of the various officers of the District. I do so move because these funds were paid into the Officers' Retirement and Severance Plan as a result of violations by the officers of fiduciary duties to



the union and its members under the law of California, and also under Section 501(a) of the Federal Labor Management Reporting & Disclosure Act of 1959.

'This action must be taken prior to the regular meeting at San Francisco, March 11, 1965.

‘/s/ John L. Connolly.’

“The motion was seconded by Brother Andrew DiMiceli.

“Brother Connolly answered a question about the time limit in the last sentence of the motion. Brother Horner made a few remarks about the reason for the motion. Various brothers expressed themselves. President Ferron took the floor and made a statement about the Plan and the fact that all newly elected officials had their choice between the MEBA-PMA Pension Plan or the MEBA Retirement and Severance Plan, but not both, and that there were various instances where the members had received severance payments when their ships were sold foreign.

“After President Ferron spoke, Brother Horner asked again for the floor to give, as he stated, ‘his rebuttal.’ President Ferron challenged Brother Horner because he had previously spoken a couple of times. The issue was decided by the members who voted in a majority to let Brother Horner continue speaking.

“After Brother Horner finished speaking, President Ferron took issue with some statements made by Brother Horner.

“Brother Pelick moved the previous question, seconded by Brother John DerBoghossian. It was



explained by the Chair that this would stop debate and place the original motion on the floor for a vote. A vote was taken on Brother Pelick's motion and by a show of hands there was no opposing votes, so Brother Connolly's motion was put to a vote. The Tellers counted 4 for the motion and 20 opposed to the motion. The motion lost."

(Exhibit E attached to affidavit of Wesley A. Ferron, C.T. 80.)

The minutes show and Horner admits that he spoke in support of his resolution at Wilmington. (R.T. April 15, 1965, p. 15.) The minutes of the District's Seattle Branch for March 10, 1965 indicate that 54 members were present and that the following occurred:

"The minutes of San Francisco, Wilmington and Portland were read. No meeting was held in Honolulu last month due to lack of a quorum. Brother Salovich re-read the motions made by Brother Connolly in Wilmington and Brother Romero in San Francisco re the MEBA Officers' Retirement & Severance Plan. Motion was made by Brother F. E. Walton, seconded by Brother Axel Edblad to approve the minutes of the other ports as read, and to concur with the action of the membership in San Francisco and Wilmington in rejecting the motion of Brothers Connolly and Romero re MEBA Officers' Retirement & Severance Plan. Motion carried, 42 FOR; 0 AGAINST."

(Exhibit F attached to affidavit of Wesley A. Ferron, C.T. 80.)

The minutes of the District's Portland Branch for March 9, 1965 indicate that 11 members were present and that the following occurred:

"Unfinished Business and Minutes of other Ports: Minutes of Wilmington Branch of February 8, 1965 were read, minutes of Seattle Branch of February 10, 1965 were read and minutes of San Francisco of February 11, 1965 were read. The Chair called attention to the Motion by Brother John L. Connolly, re: MEBA Retirement and Severance Fund, in the Wilmington minutes and the Motion by Brother V. Romero, re: MEBA Retirement and Severance Fund, in the San Francisco minutes. After discussion it was moved by Brother Geo. Miller and seconded by Brother J. F. Yarger that the minutes of Wilmington, Seattle and San Francisco be approved as read, and that the Motions of Brothers Connolly and Romero be rejected. Vote on Motion, 10 for, 0 against. Motion Carried."

(Exhibit G attached to affidavit of Wesley A. Ferron, C.T. 80.)

As indicated, the Honolulu Branch had no meeting in February because of lack of a quorum.

The record also indicates that on December 18, 1963 the District's Executive Committee adopted the following resolution:

"Moved and seconded that the PCD make contributions on full time paid officials of PCD to MEBA-PMA Pension Plan who are not covered by the Union Retirement Severance Plan and who have not established twenty (20) years

credits under the MEBA-PMA Pension Plan. Adopted."

(Exhibit A attached to affidavit of Wesley A. Ferron, C.T. 80.)

The minutes of the January 9, 1964 meeting of the San Francisco Branch indicate that 198 members were present and that the actions taken by the Executive Committee, including the one set forth above, were approved by a vote of 64-2. (Exhibit B attached to Affidavit of Wesley A. Ferron, C.T. 80.)

In addition, the District payments to the MEBA Retirement and Severance Plan are included in quarterly financial statements which are voted on and approved by the members of the District. (R.T., March 31, 1965, pp. 40-42.)

All the alleged facts, upon which appellants rely, were contained in a report of a committee, of which Horner was a member, made during July of 1961. (C.T. 22, 26, 63.) The record indicates that Horner has not been impeded from asserting his views and presenting motions against the MEBA Retirement and Severance Plan at union meetings. Yet, with Horner's version of the facts before them, the members of District have, on every occasion, voted in favor of the plan. If the members of District believed that the plan was unauthorized or that they did not wish it to be continued they would not continue to vote money for payments and they would have voted for Horner's resolution. It is clear that the various votes by the members of the District cited above, with full disclo-

sure and open discussion before the membership, clearly constituted ratification of the MEBA Retirement and Severance Plan, even assuming *arguendo* that the plan was not properly authorized in its inception.

#### 4. Appellants Did Not Exhaust Their Internal Union Remedies.

Appellants devote a good portion of their Opening Brief to the question of whether exhaustion of union remedies is a prerequisite for bringing a suit under Section 501(b) of LMRDA. (Appellants' Opening Brief, pp. 24-30.) In this discussion they point to a conflict in cases on this point. Appellees contend that the line of cases, headed by *Penuelas v. Moreno*, *supra*, which hold that exhaustion of internal remedies is a prerequisite to bringing suit, is correct. However, appellees see no need to dwell on this point. Even if it be assumed, for the sake of argument only, that exhaustion of internal union remedies is not a mandatory prerequisite for bringing a suit under Section 501(b) of LMRDA, it is still a factor which may be considered in the exercise of discretion by the District Court on whether good cause exists.

"We need not decide whether exhaustion of remedies provided by the Union is an absolute requirement before asking the federal courts to intervene in intra-union activities. *Penuelas v. Moreno*, S.D. Cal. 1961, 198 F.Supp. 441; *Acevedo v. Bookbinders & Machine Operators Local No. 25*, S.D.N.Y., 1961, 196 F.Supp. 308; *Smith v. General Truck Drivers, Union Local 467*, S.D. Cal., 1960, 181 F.Supp. 14; *Holderby v. International Union of Operating Engineers, Local Un-*

ion No. 12, 1955, 45 Cal.2d 843, 291 P. 2d 463. But Cf. *Detroy v. American Guild of Variety Artists*, 2 Cir. 1961, 286 F.2d 75.

“We find here no uncertain or futile remedy offered to appellants by their own organization. In the absence of such a factual situation, we recognize and reaffirm ‘the declared policy [of the courts] favoring self regulation by unions,’ *Detroy v. American Guild of Variety Artists*, supra at 81.”

(*Edsberg v. Local Union No. 12 of Int. U. of Operating Eng.* (9th Cir. 1962) 300 F.2d 785, 787, 788.)

The record indicates that appellants could (1) request the membership not to approve appropriations for the MEBA Retirement and Severance Plan; (2) request the District Executive Committee to submit a referendum on the issue; (3) bring the matter to the National Executive Committee and (4) bring charges against the officials of District. (C.T. 138.) The National MEBA Constitution is attached to the affidavit of W. A. Ferron in Supp. C.T. as well as a copy of District's By-Laws. The By-Laws are also found in Exhibit H attached to the Affidavit of Wesley A. Ferron, C.T. 80.)

While appellants state that exhaustion of the internal union remedies indicated would be “futile and unreasonable” (Appellants' Opening Brief, p. 31) the record indicates that this contention is not correct. For example, while appellants claim that calling a referendum is discretionary with the District Ex-



ecutive Committee, appellant Horner's own testimony indicates the simple procedure utilized by a member to obtain a referendum on another issue. (R.T. April 15, 1965, pp. 10-11.) Furthermore, the District Court, which had the National MEBA Constitution and District's By-Laws before it, and which observed the credibility of Horner, could have determined that appellants did not desire to utilize any internal remedies which might be available to them.

**5. The Proposed Complaint Is Stale and Barred by the Statute of Limitations.**

The contention was raised in Action No. 41678 that the matters sought to be complained of in this action were barred by the statute of limitations. The District Court was aware of this contention. If leave to file the proposed complaint herein were granted, appellees contend it is since barred by the statute of limitations of three years.

The LMRDA contains no limitations period. When an action is brought in a United States District Court to enforce a federally created right in which the federal statute contains no limitations period, the District Court must apply the analogous statute of limitations of the state in which it is sitting. (*Cope v. Anderson*, 331 U.S. 461, 67 S.Ct. 1340, 91 L.Ed. 1602; *McClaine v. Rankin*, 197 U.S. 154, 25 S.Ct. 410, 49 L.Ed. 702; *Burnham Chemical Co. v. Borax Consolidated* (9th Cir. 1948) 170 F.2d 569, cert. denied, 336 U.S. 924, 69 S.Ct. 655, 93 L.Ed. 1086, rehearing denied, 336 U.S. 955, 69 S.Ct. 878, 93 L.Ed. 1109, motion denied, 337 U.S. 961, 69 S.Ct. 1529, 93 L.Ed. 1760.)



The statute of limitations applicable to an action attempted to be filed under LMRDA in the Northern District of California is Section 338(1) of the California Code of Civil Procedure. (*Burnham Chemical Co. v. Borax Consolidated*, *supra*, 170 F.2d 569; *Culver v. Bell & Loffland* (9th Cir. 1944) 146 F.2d 29; *Farris v. San Diego Federal Savings & Loan Association* (S.D. Cal. 1956) 140 F.Supp. 703; see also *Levy v. Paramount Pictures* (N.D. Cal. 1952) 104 F.Supp. 787; *Englander Motors, Inc. v. Ford Motor Company* (6th Cir. 1961) 293 F.2d 802; *Alvado v. General Motors Corporation* (S.D.N.Y. 1961) 194 F.Supp. 314; *Delman v. Federal Products Corporation* (D.R.I. 1955) 136 F.Supp. 241.)

Section 338(1) of the California Code of Civil Procedure provides that "An action upon a liability created by statute, other than a penalty or forfeiture" must be brought within three years. Aside from the proposed complaint being time barred on its face, appellant Horner's own statements indicate that he was aware of all the matters alleged in the proposed complaint by July of 1961. (C.T. 22, 26, 63.) The motion for leave to file the proposed complaint was presented on March 31, 1965. (C.T. 145.) This was almost seven years from the execution of the trust agreement on May 1, 1959 and more than three years from July of 1961. Assuming, for the sake of argument only, that a cause of action once existed, under these circumstances it was clearly barred by the statute of limitations. The District Court, applying its discretion as to whether there was good cause for

filing the proposed complaint, could have determined that the complaint contained a stale claim barred by the statute of limitations of three years.

**6. Appellants Did Not Comply With Rule 23(b), Federal Rules of Civil Procedure.**

Rule 23(b) of the Federal Rules of Civil Procedure deals with class actions. Appellees contended that the proposed complaint did not meet the requirements of the rule. (C.T. 110.) Rule 23(b) refers to “an action brought to enforce a secondary right on the part of one or more shareholders in an association, incorporated or unincorporated, because the association refuses to enforce rights which may properly be asserted by it. . . .” Appellants, by attempting to file the proposed complaint “for the benefit of The Pacific Coast District of National Marine Engineers’ Beneficial Association, an unincorporated association” (C.T. 65) come within the purview of Rule 23(b). That rule also provides that:

“The complaint shall also set forth with particularity the efforts of the plaintiff to secure from the managing directors or trustees and, if necessary from the shareholders such action as he desires, and the reasons for his failure to obtain such action or the reasons for not making such effort.”

The District Court had before it the Constitution of the National MEBA and the District’s By-Laws, which indicated that internal union remedies were available to appellants. The District Court could properly conclude that the general allegations in

paragraph VIII of the proposed complaint (C.T. 68) did not meet the requirements of Rule 23(b).<sup>6</sup> The District Court, in exercising its discretion on whether good cause for filing the proposed complaint existed, could also have found that failure to conform to Rule 23(b) indicated a lack of good cause.

---

### CONCLUSION

On each of the foregoing grounds there was sound and sufficient reason for the ruling of the District Court and appellees submit that the District Court's order denying leave to file the proposed complaint should be affirmed.

Dated, San Francisco, California,  
January 5, 1966.

Respectfully submitted,

JARVIS, MILLER & STENDER,

By MARTIN J. JARVIS,

*Attorneys for Appellees, W. A. Ferron,  
Henry Borello, W. H. Buttram, Robert  
H. Horne, C. W. Jenkins, F. E. Walton,  
C. Black, H. Coleman, S. R. Franks,  
George B. Salovich and Francis H.  
Rogers.*

---

<sup>6</sup>If appellants had alleged what they had done with particularity, they would have necessarily disclosed, among other things, the votes of the District membership at the various Branch meetings, adverse to their contentions ratifying the MEBA Retirement and Severance Plan, even if initial improper adoption were to be assumed *arguendo*.

## CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

MARTIN J. JARVIS,

*Attorney for Appellees.*



No. 20,120

**United States Court of Appeals  
For the Ninth Circuit**

LOUIS HORNER, JOHN L. CONNOLLY, VICTOR ROMERO, JAMES RIEMERS, and HUGH BELL for the benefit of THE PACIFIC COAST DISTRICT OF NATIONAL MARINE ENGINEERS' BENEFICIAL ASSOCIATION, an unincorporated association,

*Appellants,*

vs.

W. A. FERRON, HENRY A. BOREILLO, W. H. BUTTRAM, ROBERT H. HORNE, C. W. JENKINS, HARRY LEWIS, R. H. ROBINSON, F. E. WALTON, C. BLACK, H. COLEMAN, S. R. FRANKS, GEORGE B. SALOVICH, FRODE ANDERSEN, FRANCIS H. ROGERS, CHEMICAL BANK NEW YORK TRUST COMPANY, a New York corporation, and FIRST DOE through TENTH DOE, inclusive,

*Appellees.*

**Appeal from an Order Denying Application and Motion to File  
Complaint, of the United States District Court for the  
Northern District of California, Southern Division  
Honorable George B. Harris, Judge**

**APPELLANTS' OPENING BRIEF**

STARK & CHAMPLIN,  
By JOHN F. WELLS,  
JOHN F. BANKER,  
ALFRED N. GERTMENIAN,  
1100 Financial Center Building,  
Oakland, California 94612,

*Attorneys for Appellants.*

FILED  
OCT 12 1961





## Subject Index

---

	Page
Jurisdictional statement .....	1
Statement of the case .....	2
A. Summary of the case .....	2
B. Statement of facts .....	4
1. The Severance Plan was entered into on behalf of Local 97 without authority .....	4
2. District funds were paid into the Severance Plan without authority .....	7
3. Relationship of the Local 97 action to the instant action .....	7
4. Evidence adduced by appellees in opposition to the filing of the complaint .....	8
(a) Ratification .....	9
(b) Exhaustion of internal union remedies .....	11
Specification of errors .....	14
Argument .....	14
A. Summary of argument .....	14
1. Ratification .....	14
2. Exhaustion of union remedies .....	15
3. "Law of the Case" .....	15
4. Rule 23 of the Federal Rules of Civil Procedure ..	15
B. Appellants fully satisfied the "good cause" require- ment of Section 501(b) .....	16
1. The legal standard: "Good cause" under Section 501(b) is established by a prima facie showing of merit .....	16
2. The unauthorized payment or use by a union official of union funds violates Section 501(a) .....	18
3. The evidence adduced below showed an unauthor- ized use of union funds by union officials for their personal benefit .....	19
(a) Ratification .....	20
C. Exhaustion of internal union remedies .....	23

	Page
1. The statutory framework of the LMRDA .....	23
2. Exhaustion of union remedies is not a prerequisite to suit under §501 .....	24
3. Nature of the exhaustion requirement under Section 411(a)(4) .....	27
4. Exhaustion: the "internal remedies" purportedly available to appellants were both futile and unreasonable .....	31
(a) Referendum .....	32
(b) Code of Trial by Charges .....	33
D. The doctrine of the law of the case is inapplicable ....	34
E. Rule 23 of the Federal Rules of Civil Procedure did not bar the filing of appellants' complaint .....	35
Conclusion .....	37

### Table of Authorities Cited

Cases	Pages
Berkwitz v. Humphrey (N.D. Ohio, 1958) 163 F. Supp. 78	20
Bland v. Connolly (Cir. D.C., 1961) 293 F. 2d 852.....	35
Branch v. Vickers, Inc. (E.D. Mich., 1962) 209 F. Supp. 518	29
Brown v. Brown (D.C. Cir., 1941) 122 F. 2d 219.....	34
Central Ry. Signal Co. v. Longden (Cir. 7, 1952) 194 F. 2d 310 .....	22
Deluhery v. Marine Cooks and Stewards Union (S.D. Cal., 1961) 199 F. Supp. 270.....	26, 29
Detroy v. American Guild of Variety Artists (Cir. 2, 1961) 286 F. 2d 75, cert. den. 366 U.S. 929, 81 S. Ct. 1650, 6 L. Ed. 2d 388 .....	28, 29, 33
Executive Board, Local Union No. 28, I.B.E.W. v. Int'l Bro. of Electrical Workers (D. Md., 1960) 184 F. Supp. 649	17
Gaynor v. Buckley (Cir. 9, 1963) 318 F. 2d 432.....	22

	Pages
Hancock Oil Co. v. Universal Oil Products Co. (Cir. 9, 1941) 120 F. 2d 959, cert. den. 62 S. Ct. 127, 314 U.S. 666, 86 L. Ed. 533 .....	34
Highway Truck Drivers and Helpers Local 107 v. Cohen (E.D. Pa. 1960) 182 F. Supp. 608, aff'd 284 F. 2d 162, cert. den. 365 U.S. 833.....	16, 18
Holdeman v. Sheldon (S.D. N.Y., 1962) 204 F. Supp. 890 .....	23, 24, 26
National Machinery Company v. Waterbury Farrel Foundry and Machine Company (Cir. 2, 1961) 290 F. 2d 527.....	34
Nelson v. Johnson (D. Minn., 1963) 212 F. Supp. 233, aff'd (Cir. 8, 1963) 325 F. 2d 646.....	26
Persico v. Daley (S.D. N.Y., 1965) 239 F. Supp. 629.....	26
Thomas v. Penn Supply and Metal Corporation (E.D. Penn., 1964) 35 F.R.D. 17.....	30
United Brotherhood of Carpenters & Joiners of America v. Brown (Cir. 10, 1965) 343 F. 2d 872.....	19
United States v. United States Smelting, Refining & Mining Company (1950) 339 U.S. 186, 94 L. Ed. 750, rehearing den. 339 U.S. 972, 94 L. Ed. 1379.....	34
Winkelman v. General Motors Corporation (S.D. N.Y., 1942) 44 F. Supp. 960.....	22

### Statutes

28 U.S.C. Section 1291 .....	2
Labor Management Reporting and Disclosure Act of 1959, (73 Stat. 519, et seq.) :	
29 U.S.C. Section 401, et seq. ....	2
29 U.S.C.A. Section 401(b) .....	23
Section 411 .....	23, 24
Section 411(a)(4) .....	15, 27, 28
Section 411(a)(5) .....	29
Section 412 .....	23, 24, 28
Subchapter II, 29 U.S.C.A. Sections 413-414 .....	23
Subchapter III, 29 U.S.C.A. Sections 431-440 .....	23

	Pages
Section 440 .....	24
Section 461 .....	23
Section 462 .....	23
Section 463 .....	23
Section 464 .....	23, 24
Section 465 .....	23
Subchapter IV, 29 U.S.C.A. Section 466 .....	23
Subchapter V, 29 U.S.C.A. Sections 481-482 .....	23
Section 482 .....	23, 24
Section 483 .....	23
Section 501 .....	3, 4, 11, 15, 23, 26, 27, 31
Section 501(a) .....	2, 18, 19, 23, 24
Section 501(b) .....	2, 16, 17, 24, 25, 26, 27, 28, 35
Subchapter VI, 29 U.S.C.A. Section 504 .....	23

### Rules

#### Federal Rules of Civil Procedure:

Rule 23 .....	8, 9, 15
Rule 23(b) .....	35, 36, 37

# United States Court of Appeals For the Ninth Circuit

---

LOUIS HORNER, JOHN L. CONNOLLY, VICTOR ROMERO, JAMES RIEMERS, and HUGH BELL for the benefit of THE PACIFIC COAST DISTRICT OF NATIONAL MARINE ENGINEERS' BENEFICIAL ASSOCIATION, an unincorporated association,

*Appellants,*

vs.

W. A. FERRON, HENRY A. BOREILLO, W. H. BUTTRAM, ROBERT H. HORNE, C. W. JENKINS, HARRY LEWIS, R. H. ROBINSON, F. E. WALTON, C. BLACK, H. COLEMAN, S. R. FRANKS, GEORGE B. SALOVICH, FRODE ANDERSEN, FRANCIS H. ROGERS, CHEMICAL BANK NEW YORK TRUST COMPANY, a New York corporation, and FIRST DOE through TENTH DOE, inclusive,

*Appellees.*

Appeal from an Order Denying Application and Motion to File Complaint, of the United States District Court for the Northern District of California, Southern Division  
Honorable George B. Harris, Judge

## APPELLANTS' OPENING BRIEF

---

### JURISDICTIONAL STATEMENT

On March 31, 1965, appellants moved the United States District Court for the Northern District of



California, Southern Division, for leave to file a complaint against appellees for breach of fiduciary duties under the Labor Management Reporting and Disclosure Act of 1959, 73 Stat. 519 et seq.; 29 U.S.C. §401, et seq. (hereinafter the "LMRDA"). (C. 141-142; 1 R. 1:6).<sup>1</sup> Jurisdiction of the District Court was based upon 29 U.S.C. §501(b).

On April 15, 1965, a final decision was entered denying appellants leave to file the complaint (C. 145-146). Notice of Appeal was filed on April 26, 1965 (C. 147). Jurisdiction of the United States Court of Appeals for the Ninth Circuit is founded on 28 U.S.C. §1291.

---

## STATEMENT OF THE CASE

### A. Summary of the Case.

Section 501(a) of the Labor Management Reporting and Disclosure Act of 1959, 29 U.S.C. §§401-531, imposes fiduciary duties upon the officers of labor organizations; Section 501(b) authorizes civil damage actions for violation of such duties, but provides, *inter alia*, that "No such proceeding shall be brought except upon leave of the court obtained upon verified application and for good cause shown, which application may be made ex parte." The present appeal is from a ruling of the lower court that appellants failed

---

<sup>1</sup>The Clerk's Transcript will be designated "C." The Reporter's Transcript for March 31, 1965 will be designated "1 R"; the Reporter's Transcript for April 15, 1965 will be designated "2 R." Page references precede the colon and line references, where specified, follow the colon.

to show "good cause" for bringing these proceedings under Section 501.

The complaint herein was sought to be filed by members of the Pacific Coast District of the National Marine Engineers' Beneficial Association (hereinafter referred to as the "District"), a labor organization, against certain District officers for violation of their fiduciary duties under Section 501 (C. 65-70). Appellants seek recovery for District of funds unlawfully paid into a Retirement and Severance Plan for District officers (hereinafter the "Severance Plan") (C. 67:1-17). This is a companion action to that previously filed in the same court on behalf of Local 97 of the Marine Engineers' Beneficial Association (hereinafter "Local 97") (C. 76:25-78:3). The Local 97 action seeks recovery of Local 97 funds unlawfully paid into the same Severance Plan (on behalf of Local 97 officials) prior to April 1, 1962, when District was formed to assume the functions of Local 97 and other locals in the Pacific Coast territory; the instant action is for recovery of District Funds paid into the Plan since April 1, 1962, on behalf of District officials.

Appellants contend, in brief, that the officials of Local 97 (defendants in the Local 97 action) contributed Local 97 funds into the Severance Plan without authority from the membership of Local 97 to do so, and that since the formation of District, officials of District (defendants and appellees herein) have, likewise without authority, contributed District funds into the same Plan.

The Local 97 action is at issue and pending trial, the District Court having ruled that there was "good cause" for bringing that action (C. 77:4-13). The present action was sought to be filed in order to adjudicate, in a consolidated trial, the similar rights of District, Local 97's successor, with respect to the same Severance Plan. However, in the present action the lower court ruled, for unstated reasons, that "good cause" had not been shown (C. 145-146).

#### **B. Statement of Facts.**

The showing of good cause made by appellants at the hearing below<sup>2</sup> was based upon the verified complaint (C. 65-70) and upon the declarations of Louis Horner (C. 76-78; 112-116) and John F. Banker (C. 72-73). Declarations and affidavits filed in the Local 97 action were incorporated by reference into the documents filed in this case (C. 77:11-13). These documents set forth the following facts:

1. **The Severance Plan was entered into on behalf of Local 97 without authority.**

On July 5, 1956, the membership of Local 97 passed Resolution 327, which provided, *inter alia*, as follows:

Whereas: A pension program has been established for MEBA members which is being maintained by contributions from the shipping companies perfected through our collective bargaining agreement, and

---

<sup>2</sup>Although Section 501 expressly provides that a showing of good cause may be made *ex parte*, appellants gave notice to appellees of the time and place when they would seek an order permitting them to file their complaint (C. 141-142), and appellees appeared and contested the motion (1 R. 3:18-4:13).

Whereas: There should also be established, in all fairness, *a retirement* program for our full time Union Officials, and

Whereas: It would not be consistent with sound Union Policy for our Union Officials to come under the Pension Plan to which shipping companies contribute, and therefore, the *retirement* plan for Union Officials should be *independent and separate*. Now Therefore Be It Resolved:

1. An *independent and separate retirement* plan shall be established for the full time Union Officials.

(Emphasis added) (C. 29).

At the time Resolution 327 was passed, the full time officials of Local 97 “represented to the membership that this resolution would be necessary to relieve an unfairness to them resulting from the fact that a pension program for the rank and file members had recently been established by agreement with the Pacific Maritime Association” (C. 24:7-11).

Nearly three years later, on May 1, 1959, without further notice to the membership of Local 97, officials of Local 97 purported to execute the Retirement and Severance Plan which is the subject of this suit (C. 1-K; 24:25; 64). That plan conferred on union officials substantial severance benefits (Trust Agreement, Section VII, C. 4-6), although Resolution 327 did not authorize severance benefits; moreover, it actually *duplicated* existing rank and file pension rights of the officials (C. 24:25-25:11; 27:26-28:1) although the stated reason for passing Resolution 327 was that

union officials should *not* “come under the Pension Plan to which shipping companies contribute” (C. 29).

As Mr. Horner declared, “No one suggested to the membership at that time [when Resolution 327 was passed], nor did I learn until years later, that a *severance* plan was under consideration by these officials whereby *upon quitting* or retiring a *union official would be entitled to a cash benefit* in lieu of a pension. No one explained at that time, nor did I learn until years later, that the full time union officials, including defendants Ferron, Andersen, Borello and Rogers, would [also] become eligible upon their eventual retirement, for a [second] pension under the P.M.A. plan.” (Emphasis added) (C. 24:21-28).

From 1956, when Resolution 327 was passed, until 1961 (the Severance Plan was executed in 1959) the membership of Local 97 was not notified of the nature and scope of the Severance Plan (C. 24:29-26:19). It was only after an investigating committee was established, through the efforts of appellants, that full details of the unauthorized Severance Plan were learned (C. 26:17-19; 63-64). Efforts of the officials to prevent this committee from carrying out its investigation resulted in a fist fight, an unlawful arrest, and a protracted civil suit for malicious prosecution (C. 25:17-32).

On August 6, 1963, appellants filed the Local 97 action, seeking return of the funds contributed by Local 97 into the Severance Plan (C. 76:25-77:3). After the introduction of voluminous documentary



evidence and extensive argument at a contested hearing, the District Court ruled that “good cause” for filing the Local 97 action had been established (C. 77:4-17). That action is now at issue and pending trial.

**2. District funds were paid into the Severance Plan without authority.**

District was formed on April 1, 1962, to assume the collective bargaining functions of Local 97 and other locals in the Pacific Coast region (C. 77:18-21). The formation of District was authorized by a “referendum vote” of the members of the locals involved (1 R. 29:17-30:9). While the membership was informed that District would assume the obligations of said Locals (1 R. 29:17-30:21), the membership was *not* informed that the officials of District would become participants, at District expense, in the Severance Plan (1 R. 37:13-38:20). At no time did the membership of District authorize its officers to participate in said Plan (C. 77:23-26).

**3. Relationship of the Local 97 action to the instant action.**

Appellants contended below that the pendency of the Local 97 action in and of itself established “good cause” for the instant suit:

The purpose of the instant action is to recover for The Pacific Coast District and its members the moneys paid by defendant officials into the retirement and severance plan. . . . the court has already upheld plaintiffs’ cause of action as against defendants’ motion to dismiss, in the case of *Horner et al. v. Local 97*; and said case seeks to revoke and set aside precisely the same retire-



ment and severance plan involved herein, upon the same grounds asserted herein, as respects Local 97, the predecessor of The Pacific Coast District. Said ruling of the court establishes good cause for the filing of the instant action.

(C. 77:27-78:3).

Counsel for appellees conceded the relationship of the two actions:

The Court: To what extent would the companion case, so far as the issues presently joined, be determinative of the issues here?

Mr. Jarvis: If the Court reaches the merits, it would be completely determinative of it, Your Honor.

The Court: Because there is no question about the succession in interest of the Pacific Coast organization?

Mr. Jarvis: Correct.

The Court: As a matter of law.

Mr. Jarvis: Correct.

(1 R. 60:5-15).

4. Evidence adduced by appellees in opposition to the filing of the complaint.

At the hearing below, appellees opposed the filing of a complaint on four grounds: (1) that the Severance Plan had been purportedly "ratified" by District (C. 102:29-104:5), (2) that appellants had not exhausted internal remedies (C. 104:29-110:8), (3) that a prior ruling respecting the joinder of District in the Local 97 action was res judicata (C. 99:18-101:25) and (4) that the complaint did not meet certain technical pleading requirements of Rule 23 of the

Federal Rules governing pleadings in shareholders' derivative actions (C. 110:10-111:6). Said opposition was based on the affidavit of defendant Wesley Ferron, president of the District (C. 79-80) and on Ferron's oral testimony (1 R. 27-50).

(a) Ratification.

As respects ratification, the Ferron affidavit incorporated copies of the minutes of the three meetings of *Branches* of District (San Francisco and Wilmington) reflecting the defeat, at Branch meetings, of motions by appellants that District sue to recover funds paid into the Severance Plan (C. 79-80; C. 103:12-32). Further Branch votes, to concur in the San Francisco and Wilmington votes, were had at Seattle and Portland, presumably on motion of appellees (C. 80; 103:32-104:5). The total votes cast against suit at all of said recent Branch meetings was 167 (C. 103:25-104:5); District is comprised of approximately 3,000 members (C. 115:15-16).

Mr. Horner's affidavit established that *none* of these Branch votes, relied upon as "ratifications," were upon motions to *ratify* the Severance Plan:

Defendant Wesley A. Ferron at no time stated or suggested to the membership that a *vote not to file suit*, as moved by me, would constitute a *ratification* of the Plan itself. Nothing whatever was said on said occasion which could have led any member present to believe that he was voting to ratify or not to ratify the Plan itself; the membership was led to believe only that the motion was exactly what it purported to be, a motion

to instruct the officers of Pacific Coast District to file suit.

(C. 113:15-21).

Ferron further testified, on the ratification point, that when the locals voted to form District, "a letter of explanation . . . went along to each of the members explaining . . . that the District would assume the obligations for the individual locals." (1 R. 30:18-21). Because of such letter, he claimed, the vote to merge was a vote to ratify the Severance Plan (1 R. 30:22-31:2). On cross-examination, Ferron conceded that there was no specific vote on ratification of the Severance Plan, but only a general vote on the subject of merger (1 R. 38:12-14), and that the letter respecting assumption of obligations did not mention the Severance Plan (1 R. 35-38).

The final purported "ratification" was a vote on January 9, 1964, again at a *Branch* meeting (Ex. B to Ferron Affidavit, C. 80:10-12), to approve the minutes of a December 18, 1963 meeting of the District Executive Committee (comprised of appellees) (Ex. A to Ferron Affidavit, C. 80-7-9). The Executive Committee had voted to add the *newly elected* officials of the District to the Severance Plan (but not the officials, including appellee Ferron, who had been participating since April 1, 1962) and to obligate the District to contribute District funds on their behalf into the Plan (Ex. A to Ferron Affidavit). The San Francisco Branch had, according to the minutes of its meeting, voted generally to approve the actions of the Execu-

tive Committee (Ex. B to Ferron Affidavit). The total number of votes so cast was 64, approximately 2% of the membership of District.

Finally, the Horner affidavit stated that said votes were based upon concealment and false statements by defendant Ferron respecting the validity of the Severance Plan:

Because our union is comprised of a seagoing membership and there is minimal continuity of attendance at meetings, defendants have been able to dominate and control said meetings. *No defendant has ever made a full and honest disclosure to the membership of the invalid nature of the Severance Plan or of the basis for plaintiffs' objection to it. On the contrary, defendants have consistently represented to the membership that the Plan was properly authorized; said representation has been false; and it has been that representation which has induced the membership to vote as they have.*

(C. 114:11-19).

**(b) Exhaustion of internal union remedies.**

The principal contention advanced by appellees below was that appellants had not exhausted internal union remedies before seeking judicial relief under Section 501 (C. 104:28-110:8; 138:15-140:2). Appellants urged primarily that Section 501 does not require such exhaustion (C. 132:14-134:13), and secondly, that the District procedures do not afford a remedy for the breaches of trust involved in this case (C. 134:14-136:4).

Appellees argued below that three “internal remedies” had been available to appellants: (1) A “referendum vote” of the entire membership of District, pursuant to Article VI 5(1) of the District by-laws (C. 138:22-29); (2) a trial procedure “of any person charged with any offense” under Articles VI 7(a) and (b) and Article XIII of the District by-laws (C. 138:30-139:2); and finally, (3), a trial procedure under the National Constitution for “charges against elective officials of a District.” (C. 139:11-21).

(i) *Referendum vote.* It was undisputed that no individual member has the power, under the District By-laws, to secure a referendum vote. The By-laws provide that:

The *District Executive Committee* has the authority whenever *it* may determine that it is in the best interest of the membership, to submit to a referendum vote among the membership, any issue, policy or action.

(C. 138:23-29).

Appellees contended that an individual member may *request* the District Executive Committee to hold a referendum vote (1 R. 55-13-15); but it was undisputed that appellants “have requested the District, its Executive Committee and Officers to take *such action as might be necessary*” to recover the disputed funds (C. 68:17-19; emphasis added); and no referendum vote has been held by the Executive Committee (1 R. 44:4-14). The Executive Committee is, of course, comprised of appellees themselves (C. 115:8-10).



Appellees introduced no evidence showing or tending to show how or in what manner such a vote would secure the return to District of the funds; the referendum remedy was apparently advanced only as a means for preventing future payments into the Plan. Its effectiveness even for this purpose was questionable, inasmuch as the District By-laws provide that the District Executive Committee (appellees) may override a referendum vote (Article III, Section 1).

(ii) “*Trial by Charges*” under *District By-laws*. While the District By-laws provide procedures for the “trial” of a member charged with “any offense,” (C. 138:30-130:2; 80:28-29, Exhibit H), said By-laws expressly provide (Article XII, Section 1) that the *National Constitution* shall govern “the filing of any charges” and the National Constitution imposes special restrictions, described below, upon the filing of charges against a District *official*. Since appellees are District officials, the National Constitution, not the District By-laws, govern charges against them.

(iii) “*Trial by Charges*” under the *National Constitution*. Under the National Constitution, an *individual* union member does *not* have a right to bring charges against an elected District officer. Such charges may be brought *only* by a “National full-time elected officer or any three members of the National Executive Committee or by a 10% vote of the members in good standing of said District.” (Article VIII, Section 1; C. 129:12-19).

Appellees introduced no evidence showing or tending to show how or in what manner such trial proce-



ture would secure the return to District of the funds at issue; indeed, the National Constitution expressly provides that “A decision rendered . . . against any accused . . . shall not in any way affect . . . his civil liability under the law to the National Association or any District.” (Article XIII, Section 11).

---

### **SPECIFICATION OF ERRORS**

The lower court erred in ruling that good cause had not been shown for bringing this action.

---

### **ARGUMENT**

#### **A. SUMMARY OF ARGUMENT.**

In the lower court, appellees opposed the filing of appellants’ complaint on four grounds. Appellants’ position on such grounds is as follows:

##### **1. Ratification.**

Appellees contended that the District-wide vote to merge the various locals into District, and also several Branch votes touching collaterally upon the Severance Plan constituted implied “ratifications” of that Plan. Appellants’ evidence showed, on the contrary, that each of the claimed “ratifications” was presented to the membership as a vote on an issue distinct from ratification; that in fact the membership has never been requested to vote for or against ratification; and that, in any event, appellees have *never* made the full

disclosure to the membership which is prerequisite to an effective “ratification” of a breach of trust.

## **2. Exhaustion of union remedies.**

Appellees contended that exhaustion of union remedies is a strict condition precedent to suit under Section 501. Appellants, on the contrary, urge that Section 501—unlike other provisions of the LMRDA—provides a specific statutory procedure to be followed *in lieu* of exhaustion and that appellants have complied with that procedure; moreover, that if exhaustion were required under Section 501, only “reasonable hearing procedures” need be exhausted (Section 411 (a)(4) of the LMRDA), and no such “reasonable hearing procedures” were available to appellants.

## **3. “Law of the Case.”**

Appellees contended, without citation of authority, that a ruling in the Local 97 action, denying leave to amend the complaint in that action to name District as a party, somehow barred the present suit. Appellants urge that the doctrine of “law of the case” is inapplicable because that ruling was not a final judgment. It was, moreover, based upon a procedural defect which appellants cured before bringing the instant action.

## **4. Rule 23 of the Federal Rules of Civil Procedure.**

Finally, appellees contended that the complaint should not be permitted to be filed because it failed to plead certain matters required by Rule 23, dealing with shareholders’ derivative actions. Appellants’

position is that this is not a shareholders' derivative action; and that the complaint does in fact satisfy Rule 23. In any event, a technical pleading defect cannot support the final judgment entered against appellants.

---

**B. APPELLANTS FULLY SATISFIED THE "GOOD CAUSE" REQUIREMENT OF SECTION 501(b).**

1. **The legal standard:** "Good cause" under Section 501(b) is established by a *prima facie* showing of merit.

Section 501(b), authorizing civil actions by union members against officers accused of violating the fiduciary duties imposed by Section 501(a), provides that "No such proceeding shall be brought except upon leave of the court obtained upon verified application and *for good cause shown*, which application may be made *ex parte*." (Emphasis added.) The meaning of "good cause" is not amplified by the statute.

It is apparent that the "good cause" requirement of Section 501(b)—which must be determined before a complaint may be filed—is met by a simple *prima facie* showing of merit. In *Highway Truck Drivers and Helpers Local 107 v. Cohen* (E. D. Pa., 1960) 182 F. Supp. 608, at 622, fn. 10; *aff'd* 284 F.2d 162; *cert. den.*, 365 U.S. 833, the court stated:

Although the Act does not specify what is meant by "good cause" in §501(b), it would appear that such a preliminary requirement is intended as a safeguard to the union against harassing and vexatious litigation brought with-

out merit or good faith. The fact that permission to file the complaint can be granted after an *ex parte* hearing would seem to support this view.

Thus, a verified complaint alone has been found to establish good cause: "The complaint was verified. If true, its allegations constitute 'good cause'." *Executive Board, Local Union No. 28, I.B.E.W., v. Int'l Bro. of Electrical Workers* (D.Md., 1960) 184 F. Supp. 649, at 653.

Until a complaint is filed there can, of course, be no discovery. Discovery rights are essential to a union member suing union officers under Section 501. Such members are, in the nature of things, on the outside; their access to evidence is far more limited than that of the defendant union officers. It is thus inconceivable that Congress intended that more than a "preliminary showing" of "merit" should be required of a plaintiff in order to file a complaint under Section 501(b); and "merit" in this context means not ultimate success but the presence of triable issues.

As stated during the hearing below:

[Counsel]: The showing of good cause which must be made in order to file, and I stress, Your Honor, that we are merely seeking to file a complaint and adjudicate the questions raised in it, the showing of good cause is presumably less than is required to succeed in the action on its merits. We don't need to win the suit before we file the complaint.

The Court: That is understandable, counsel.

(1 R. 6:19-7:1).

2. **The unauthorized payment or use by a union official of union funds violates Section 501(a).**

The substantive duties imposed by Section 501(a) are clear: Section 501(a) “establishes a federal duty on the part of labor union officials to abide by the ordinary rules of fiduciary responsibility.”<sup>3</sup> That section provides:

The officers, agents, shop stewards, and other representatives of a labor organization occupy positions of trust in relation to such organization and its members as a group. It is, therefore, the duty of each such person, taking into account the special problems and functions of a labor organization, to hold its money and property solely for the benefit of the organization and its members and to manage, invest, and expend the same in accordance with its constitution and bylaws and any resolutions of the governing bodies adopted thereunder, to refrain from dealing with such organization as an adverse party or in behalf of an adverse party in any matter connected with his duties and from holding or acquiring any pecuniary or personal interest which conflicts with the interests of such organization, and to account to the organization for any profit received by him in whatever capacity in connection with transactions conducted by him or under his direction on behalf of the organization . . .

An “unauthorized” payment of union funds, made “without the approval, consent or vote of the local union members” constitutes a violation of Section

---

<sup>3</sup>*Highway Truck Drivers and Helpers Local 107 v. Cohen* (E.D. Pa., 1960), *supra* at 610.



501(a). *United Brotherhood of Carpenters & Joiners of America v. Brown* (Cir. 10, 1965) 343 F.2d 872, at 884-5.

3. The evidence adduced below showed an unauthorized use of union funds by union officials for their personal benefit.

In the present case, there was little conflict as to the facts. It was undisputed that District funds were paid by appellees into the Severance Plan (C. 77:21-26; 1 R. 29:2-9), that the Plan was for the exclusive benefit of those same union officials, and that it both conferred upon said officials valuable severance benefits not available to the rank and file (C. 4-6), and also effectively duplicated said officials' retirement benefits, because they were entitled to participate concurrently both in the officials' Severance Plan and in the rank and file retirement plan (C. 24:25-25:11; 27:26-28:1).

That the Plan was initially executed by some of the appellees (then officials of Local 97) without authority or notice to the Union was virtually undisputed. The Plan was executed in 1959, pursuant to a three-year-old resolution (Resolution No. 327) which by its terms authorized only a *Retirement* Plan matching that of the rank and file membership; a resolution which plainly contemplated that separate—not duplicate—benefits would be obtained under the officials' plan (C. 29). The terms of the executed plan were not learned by the rank and file until 1961—two years after its execution—and the plan was then disclosed only reluctantly, as a result of an investigation by an



appointed committee of Local 97 (C. 26:17-19; 63-64). At that time, however, appellee Ferron—then Business Manager of Local 97—represented to the membership that the Plan *had* been authorized and that it was valid (C. 114:11-19). No action was taken by Local 97.

**(a) Ratification.**

Appellees did not dispute that the Plan was initially unauthorized; however, they contended that it was subsequently ratified by District. While admitting below that no District-wide vote specifically referring to the Plan had ever been taken (C. 113:15-21; 1 R. 35-38), appellees nevertheless argued that the Plan had been “ratified” by various votes of Branches within the District. It was undisputed that none of such votes had by its terms been a vote to ratify the Plan (1 R. 35-38); the ratification, appellees contended, was “implied.”

There were four votes which appellees claimed were “implied” ratifications of the Plan, the initial vote to form District, two votes at Branch meetings not to bring suit to recover the funds, and a Branch vote approving minutes of a District Executive Committee meeting. Respecting the Branch votes, appellees failed to indicate below how a Branch vote could constitute a ratification on behalf of the entire District.

Appellees’ effort to “imply” ratification from votes on collateral matters is similar to an argument rejected in *Berkwitz v. Humphrey* (N.D. Ohio, 1958) 163 F. Supp. 78, at 93. In *Berkwitz*, the board of di-

rectors approved a retirement profit-sharing plan for key corporate employees. The shareholders had never voted to approve the plan; they did, however, vote to set aside certain shares of stock to implement the plan. The court held that the vote to set aside the stock did not constitute ratification of the plan itself, stating: "Shareholder approval was sought on the proposal to implement the plan . . . but no approval of the plan itself was sought." In short, a vote on a collateral subject will not be construed as a ratification.

Moreover, appellants' evidence showed that, in securing the "implied ratifications," appellees had not only failed to disclose to the District Membership either the terms or the original invalidity of the Plan, they had affirmatively misrepresented that the Plan had been validly authorized at its inception (C. 114:11-19). Appellants' evidence further showed that the membership of District was transient and seagoing, that there was minimal continuity of attendance at Branch meetings, and that appellee Ferron dominated and controlled the meetings at which such votes were taken (C. 114).

Under long-established fiduciary principles, a fiduciary's unauthorized acts cannot be ratified unless the ratifying party has full knowledge of the facts surrounding the unauthorized transaction; and the party claiming ratification has the burden of proving it was made with full knowledge of all material facts.

*"For 'a cestui que trust to "ratify" or confirm a breach of trust, he must be apprised of all the material facts and as well of their legal effect. No*

half-hearted disclosure or partial discovery is sufficient in either respect. The trustee's duty of disclosure is not discharged by leaving the cestui to draw doubtful inferences, conclusions and suspicions.'

\* \* \*

*One cannot ratify that which he does not know, and the burden is upon him who relies upon ratification to show that it was made with full knowledge of all material facts.*" (Emphasis added).

*Central Ry. Signal Co. v. Longden* (Cir. 7 1952) 194 F.2d 310 at 320.

See also *Gaynor v. Buckley* (Cir. 9, 1963) 318 F.2d 432 at 435 ("the two conditions were not ratified by G-P's shareholders because they never had knowledge of them"); and *Berkwitz v. Humphrey, supra*, at 97 ("There must, of course, be a full and fair disclosure of all relevant facts if the shareholders' ratification is to be effective").

Where, as here, the act in question was one which personally benefited the fiduciary, the highest standards of disclosure are required:

Where directors seek the approval of the stockholders for a transaction in which the directors stand to profit at the expense of the corporation, *every item* of possible profit to the directors and *all information that would enable the stockholders to form a correct estimate of the benefit* accruing to the directors must be disclosed, if the approval of the stockholders is to be of any protection to the directors. (Emphasis added).

*Winkelman v. General Motors Corporation* (S.D. N.Y., 1942) 44 F. Supp. 960 at 985.

In the lower Court, appellees offered no evidence showing that they had made full disclosure; indeed, they did not even *contend* that disclosure had been made.

---

### C. EXHAUSTION OF INTERNAL UNION REMEDIES.

#### 1. The statutory framework of the LMRDA.

The LMRDA, 29 U.S.C.A. §§401-531, was enacted in 1959 as a "comprehensive revision of the labor law,"<sup>4</sup> based upon a Congressional determination, *inter alia*, "that there have been a number of instances of breach of trust, corruption, disregard of the rights of individual employees, and other failures to observe high standards of responsibility and ethical conduct." 29 U.S.C.A. §401(b).

The several subchapters of the LMRDA create distinct categories of substantive rights and duties, addressed to distinct problems. Thus, the LMRDA contains a "Bill of Rights" for the protection of union members (Subchapter II, 29 U.S.C.A. §§411-414); it imposes financial reporting obligations upon labor unions (Subchapter III, 29 U.S.C.A. §§431-440), restrictions on trusteeships (Subchapter IV, 29 U.S.C.A. §§461-466), and election requirements (Subchapter V, 29 U.S.C.A. §§481-483); and, of significance to the present case, it imposes fiduciary duties upon union officials in relation to their unions (Subchapter VI, 29 U.S.C.A. §§501-504).

---

<sup>4</sup>*Holdeman v. Sheldon* (S.D. N.Y., 1962) 204 F. Supp. 890, at 896.

The LMRDA provides varying procedures for enforcement of the substantive rights which it creates. The “Bill of Rights” (§411) is enforceable through civil suits in the federal district courts by individuals whose rights have been infringed (§412). Reporting, trusteeship and election requirements are enforceable by civil actions brought by the Secretary of Labor (§§440, 464, 482). The fiduciary obligations imposed by §501(a) on union officers are enforceable in civil suits by union members (§501(b)), provided that “the labor organization . . . refuse or fail to sue or . . . secure . . . appropriate relief within a reasonable time after being requested to do so. . . .” (§501(b)).

**2. Exhaustion of union remedies is not a prerequisite to suit under §501.**

Reasonably interpreted, the LMRDA does not require exhaustion of internal union remedies as a prerequisite to suit under Section 501. Section 501(b), authorizing civil actions by union members, does not on its face require exhaustion:

When any officer, agent, shop steward, or representative of any labor organization is alleged to have violated the duties declared in subsection (a) of this section and the labor organization or its governing board or officers refuse or fail to sue or recover damages or secure an accounting or other appropriate relief within a reasonable time after being requested to do so by any member of the labor organization, such member may sue such officer, agent, shop steward, or representative in any district court of the United States or in any State court of competent jurisdiction to recover



damages or secure an accounting or other appropriate relief for the benefit of the labor organization. No such proceeding shall be brought except upon leave of the court obtained upon verified application and for good cause shown, which application may be made *ex parte*. . . .

The express requirement of §501(b) that before suit is brought, a "request" first be made of the union and the union be afforded a reasonable time in which to sue, has been interpreted in the only appellate decision on the point, as a *substitute* for the pursuit of more complex internal remedies. *Holdeman v. Sheldon* (Cir. 2, 1962) 311 F.2d 2, *aff'ing* 204 F. Supp. 890.

As stated by the District Court in *Holdeman v. Sheldon* (S.D. N.Y., 1962) 204 F. Supp. 890, at 896:

If anything, the fact that Congress made specific reference to exhaustion of internal remedies under §101(a)(4), 29 U.S.C.A. §411(a)(4), and adopted a different procedure under §501(b), both sections being enacted at the same time as part of a comprehensive revision of the labor law, leads to the conclusion that *the concept of first exhausting internal remedies was knowingly omitted*. (Emphasis added.)

The District Court opinion in *Holdeman* was described by the Court of Appeals as a "thorough and well-reasoned opinion," and was endorsed with the statement that "all of the questions raised on this appeal were fully and adequately answered in the opinion of the court below and we affirm for the reasons there stated." *Holdeman v. Sheldon* (2nd Cir., 1962) 311 F.2d 2, at 3.



The most recent decision on the point likewise holds that Section 501 does not require exhaustion. See *Persico v. Daley* (S.D. N.Y., 1965) 239 F. Supp. 629, 632.

A single District Court decision, *Penuelas v. Moreno* (S.D. Cal., 1961) 198 F. Supp. 441, has held, on the other hand, that Section 501(b) contains an unstated exhaustion requirement. *Penuelas* was flatly rejected in *Holdeman, supra*, 204 F. Supp. 890 at 896, with the statement that "This court sees no warrant for engrafting this requirement on §501(b)"; *Penuelas* was later characterized as "questionable" by the same court in which it had been decided, see *Deluhery v. Marine Cooks and Stewards Union* (S.D. Cal., 1961) 199 F. Supp. 270, at 274; and it was generally disapproved in *Nelson v. Johnson* (D. Minn., 1963) 212 F. Supp. 233 at 257, *aff'd* (Cir. 8, 1963) 325 F. 2d 646.

As a matter of rational statutory construction, an exhaustion requirement should not be "implied" in §501(b). The explicit "request" requirement set forth in §501(b) cannot be reconciled with Congressional intent to "imply" a *further* requirement of exhaustion. The simple request specified in §501(b) would be superfluous if a member had already exhausted more formal internal remedies. Exhaustion of internal remedies necessarily entails numerous "requests" of a union, in the form of motions, petitions and the like, with responsive union decisions. The only reasonable interpretation of the request requirement in §501(b) is that placed upon it by *Holdeman*; that is, that it was intended as a *substitute* for exhaustion.

There is a plain reason why Congress did not require that internal union remedies be exhausted prior to bringing suit under Section 501: a breach of trust by a union officer is not curable internally. Internal remedies can no more cure such an injury than they can compensate the union for the negligent destruction of the union hall by fire. While internal remedies may determine questions of status, voting rights, and internal grievances generally, no internal action by the union can effectively secure money damages for a breach of trust by union officials. The only effective remedy in this setting is a judgment, and unions lack the power to render enforceable judgments.

The one material decision which a union *can* make in the context of a dispute under §501 is whether it will itself *control* proposed litigation regarding claimed abuses of trust; Section 501(b) thus requires that this decision—but only this decision—be made by the union before suit may be initiated by a union member.

### **3. Nature of the exhaustion requirement under Section 411(a)(4).**

Section 411(a)(4) of the LMRDA has been interpreted as creating a federal exhaustion doctrine. This doctrine has been derived from the provision of Section 411(a)(4) which, while protecting the right of union members to bring suit against the union or its officers, provides “that any such member *may* be required to exhaust *reasonable* hearing procedures (but not to exceed a four-month lapse of time) within such

organization, before instituting legal or administrative proceedings against such organizations or any officer thereof . . ." (Emphasis added.) As discussed above, the courts have refused to "engraft" this exhaustion doctrine upon §501(b) of the LMRDA; it has, however, been uniformly imposed in civil suits under §412 of the Act, seeking to enforce the "Bill of Rights." Such cases are discussed below.

In the leading case interpreting the exhaustion provision of §411(a)(4), *Detroy v. American Guild of Variety Artists* (Cir. 2, 1961) 286 F. 2d 75 *cert. den.* 366 U.S. 929, 81 S.Ct. 1650, 6 L.Ed.2d 388, the court held that because the statute says exhaustion "may" be required, such exhaustion is *not* an absolute condition of suit: "The statute provides that any member of a labor organization 'may be required' to exhaust the internal union remedies, not that he 'must' or 'is required to' exhaust them." *Detroy, supra*, at 78.

*Detroy* further held that such exhaustion requirement is to be imposed, if at all, by the courts, not the labor organizations, and that Congress has left to the courts the problem of formulating both the criteria for determining when the requirement "may" be imposed and also the tests for determining what internal remedies are "reasonable" within the meaning of Section 411(a)(4). See *Detroy, supra*, at 78, et seq.

*Detroy* and the subsequent cases have held that the decision to impose an exhaustion requirement must be made in the light of all the facts of each case, including the nature of the claims asserted—that is, the

merits of the case—as well as the nature of the internal remedies claimed to have been available but not pursued. The specific circumstances which were found in *Detroy* to warrant direct access to the courts, without previous exhaustion, were that the facts on their face revealed a violation of §411(a)(5), that it was not clear either that the union rules really did afford a remedy or, if a remedy existed, that it had been called to the attention of the complaining member, and, finally, that the remedy suggested was probably inadequate.

Because imposition of the requirement is thus addressed to the broad discretion of the court, a number of courts have refused to pass on the question on motion, stating that it cannot be properly determined before trial. Thus, it has been held that “the exhaustion of internal remedies is a matter which should be alleged as an affirmative defense” and that exhaustion need not be pleaded by the plaintiff; see *Branch v. Vickers, Inc.* (E.D. Mich., 1962) 209 F. Supp. 518, 520. “. . . [S]ince *Detroy* definitely established that exhaustion of union remedies is not an absolute condition precedent to federal jurisdiction, there is no pleading requirement that a plaintiff allege such exhaustion in order to defeat a motion to dismiss.” *Deluhery v. Marine Cooks and Stewards Union, AFL-CIO* (S.D. Cal., 1961) 199 F. Supp. 270, at 275.

The trend of the cases against resolving issues of exhaustion on motion was described in *Deluhery v. Marine Cooks and Stewards Union, AFL-CIO*, *supra*, at 275, as follows:

... *Where a plaintiff does not plead exhaustion, factual questions are raised as to whether the plaintiff actually did exhaust internal remedies, whether reasonable remedies were available, whether in the particular case a plaintiff should be required to utilize such remedies, which questions cannot properly be determined on a motion to dismiss but must await trial for their ultimate determination.* Cases taking or implying this approach include *Hughes v. Local No. 11 of Internat'l Ass'n of Bridge, etc.*, 287 F. 2d 810, 819 (3 Cir. 1961); *Figueroa v. National Maritime Union of America*, 198 F. Supp. 946 (D.C.S.D. N.Y. 1961); and *Rekant v. Shochtay-Gasos Union, etc.*, 194 F. Supp. 187 (D.C.E.D. Pa. 1961). In the present case, *the court is loath to determine the vital questions raised either on the basis of the pleadings or on the basis of conflicting affidavits and therefore adopts the approach of these recent cases, declining to determine the matter at this time, either on motion to dismiss or on motion for summary judgment.* (Emphasis added.)

See also, *Thomas v. Penn Supply and Metal Corporation* (E.D. Penn., 1964) 35 F.R.D. 17, at 19.

In the instant case, the lower court apparently determined "the vital questions raised" before a complaint had even been filed. Even if Section 501 required exhaustion—which it does not—it would certainly have been error to rule on the exhaustion issue prior to the commencement of the action.



4. **Exhaustion:** the “internal remedies” purportedly available to appellants were both futile and unreasonable.

Even if plaintiffs were required in a §501 action to exhaust internal remedies, no *internal* remedy, however exhaustively pursued, could cure the breaches of trust which are the subject of this action. Recovery of the funds contributed to the Severance Plan lies outside the power of the union. In *Detroy*, exhaustion was not required for the reason, *inter alia*, that it was merely *unlikely* that union remedies would resolve the dispute: “If it is *probable* . . . that court proceedings will be instituted even after the remedies are exhausted, not even the policy calling for exhaustion in order to conserve judicial resources applies.” (Emphasis added.) *Detroy, supra*, at 80. *A fortiori*, exhaustion should not be required where as here, it is *certain* that the union would be unable to remedy the complaint internally.

Moreover, the claimed “remedies” involved in this case were not even available to appellants. At the hearing below, the only internal remedies suggested by appellees were (1) Referendum (a District-wide vote), and (2) Code of Trial by Charges (C. 138-139). Such “remedies” were, on the face of the By-laws of the District and the Constitution of the National Marine Engineers’ Beneficial Association, both unreasonable and futile.



**(a) Referendum.**

The function of a “referendum” vote is generally defined in Article I of the District By-Laws as “authorization for any union action.” However, a referendum may *not* be secured by a member individually; it is *only* the *District Executive Committee* (comprised of appellees herein) which is authorized “to submit to a referendum vote among the membership any issue, policy or action.”

The *District Executive Committee shall have the authority*, wherever it may determine that it is in the best interest of the membership, *to submit to a referendum vote* among the membership any issue, policy or action. The vote thereon shall have the same binding effect as a vote by a majority of the membership. Any such referendum shall be conducted in accordance with the procedure outlined in these By-Laws for elections except that the time and duration of the vote and all other pertinent details shall be set by the District Executive Committee. (Emphasis added.)

(By-Laws, Article VI, Section 5(1).)

While it may be true, as counsel for appellees represented to the lower court, that “any member can propose . . . that a referendum vote be taken” (1 R. 55:13-15), it is equally plain from the face of the by-laws that such a “proposal” can be summarily rejected by the District Executive Committee, which is “comprised of most of the [appellees] herein,” and “dominated and controlled by [appellee] Ferron.” (C. 115:8-14). Indeed, it was undisputed that appel-

lants had made a formal demand on appellees to take whatever action was necessary to recover the subject funds; and it was undisputed that the Committee has not called for a referendum. The "remedy" of referendum was exhausted.

**(b) Code of Trial by Charges.**

The other "internal remedy" suggested by appellees was a "Code of Trial by Charges" authorized by Article XII of the District By-Laws. Section 1 of Article XII provides that the National Constitution shall govern the filing of such charges. The National Constitution, however, provides, at Article VIII, that charges involving wrongdoing by district *officers*, while in office, may only be filed by a National officer, three members of the National Executive Committee "or by a 10% vote of the members in good standing of said District."

Thus the Code of Trial by Charges, like the Referendum, is *not* available to an individual member; it can be initiated against an officer only by National executives or by 10% of the entire District membership; and its end product is at most internal discipline and not the return of the funds. In sum, the "internal remedies" proposed by appellees were not only futile, they were not even available. As stated in *Detroy*:

When asserting what is clearly a violation of a federal statute, a union member should not be required to first seek out remedies which are dubious. (p. 80).

**D. THE DOCTRINE OF THE LAW OF THE CASE  
IS INAPPLICABLE.**

Appellees contended below that a ruling in the Local 97 action, denying a motion of the plaintiffs therein to amend their complaint to join District, became "the law of the case" (C. 99-101) as to the right of appellants to file the proposed complaint in this proceeding. No authority was cited to support this argument.

Appellees' contention respecting "law of the case" was plainly inapplicable; that doctrine applies only to final judgments:

We think that it requires a final judgment to sustain the application of the rule of the law of the case just as it does for the kindred rule of *res judicata*.

*United States v. United States Smelting, Refining & Mining Company* (1950) 339 U.S. 186, at 199, 94 L.Ed. 750, at 761, *rehearing den.* 339 U.S. 972, 94 L.Ed 1379.

See also, *Brown v. Brown* (D.C. Cir., 1941) 122 F. 2d 219, at 220.

The decision in the Local 97 action denying plaintiffs' motion for leave to amend was not a final judgment. *National Machinery Company v. Waterbury Farrel Foundry and Machine Company* (Cir. 2, 1961) 290 F. 2d 527; *Hancock Oil Co. v. Universal Oil Products Co.* (Cir. 9, 1941) 120 F. 2d 959, at 960, *cert. den.* 62 S.Ct. 127, 314 U.S. 666, 86 L.Ed. 533.

Moreover, the ruling in the Local 97 action was based upon the then failure of plaintiffs to request

the District to institute the action on its own behalf, as required by Section 501(b). (C. 128:30-129:15). The ruling in the Local 97 action did not, therefore, preclude the commencement of an independent action on behalf of District *after* a proper request had been made that the District take appropriate action. The necessary request was made before commencement of the present action. A dismissal based upon the plaintiff's failure to perform some necessary procedural act does not prevent the plaintiff from seeking the same relief after the act has been performed. *Bland v. Connolly* (Cir. D.C., 1961) 293 F. 2d 852, at 855.

---

**E. RULE 23 OF THE FEDERAL RULES OF CIVIL PROCEDURE  
DID NOT BAR THE FILING OF APPELLANTS' COMPLAINT.**

Finally, appellees contended in the lower court that appellants had not "set forth with particularity the efforts of the plaintiff to secure from the managing directors or trustees and, if necessary, from the shareholders such action as he desires, and the reasons for his failure to obtain such action or the reasons for not making such effort," as required by Rule 23(b) of the Federal Rules of Civil Procedure.

Rule 23(b) is obviously designed for derivative actions instituted by corporate shareholders: it is captioned "*Secondary Action by Shareholders*", and it sets forth the prerequisites for "an action brought to enforce a secondary right on the part of one or more *shareholders*." It requires, *inter alia*, that the plaintiff

was a *shareholder* at the time the transaction of which he complains occurred, and that the complaint set forth plaintiff's attempts to have the managing *directors* or *shareholders* take the action he seeks. Rule 23(b) plainly has no application to suits brought by union members under the express authority and meeting the specific procedural requirements of the LMRDA.

However, if Rule 23(b) were applicable to the pending case, appellants would nevertheless have satisfied its requirements. The verified complaint alleges that:

Plaintiffs have requested the District, its Executive Committee, and Officers to take such action as might be necessary in order to recover for the District the above described payments to defendant Bank, but the District, Executive Committee, and Officers have refused so to do. A reasonable time for such action has now elapsed since the making of said requests. Accordingly, plaintiffs bring this suit for the benefit of the District and its Members.

(C. 68:17-23).

Appellants further alleged that they are members of District and were members at all relevant times mentioned in the complaint:

Plaintiffs Louis Horner, John L. Connolly, Victor Romero, James Riemers, and Hugh Bell are and at all times herein mentioned were members of The Pacific Coast District of National Marine Engineers' Beneficial Association.

(C. 66:18-21).

Finally, it seems perfectly clear that Rule 23 could under no circumstances support the judgment of the lower court. Even if it applied, and if the complaint were defective in that regard, the defect would at most be a technical pleading matter curable by amendment.

---

### CONCLUSION

Appellants submit that good and compelling cause exists for bringing this action. The evidence offered by appellants in the lower court would have been more than adequate to defeat either a motion to dismiss or a motion for summary judgment. Indeed, had the hearing below been a trial on the merits, appellants' evidence would have supported a judgment in their favor. Appellants' showing below was surely sufficient to entitle them to file a complaint.

Dated, Oakland, California,  
October 7, 1965.

Respectfully submitted,  
STARK & CHAMPLIN,  
By JOHN F. WELLS,  
JOHN F. BANKER,  
ALFRED N. GERTMENIAN,  
*Attorneys for Appellants.*





CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

JOHN F. WELLS,  
*Attorney for Appellants.*



**No. 20,120**  
**United States Court of Appeals**  
**For the Ninth Circuit**

---

LOUIS HORNER, JOHN L. CONNOLLY, VICTOR ROMERO, JAMES RIEMERS, and HUGH BELL for the benefit of THE PACIFIC COAST DISTRICT OF NATIONAL MARINE ENGINEERS' BENEFICIAL ASSOCIATION, an unincorporated association,

*Appellants,*

vs.

W. A. FERRON, HENRY A. BORELLO, W. H. BUTTRAM, ROBERT H. HORNE, C. W. JENKINS, HARRY LEWIS, R. H. ROBINSON, F. E. WALTON, C. BLACK, H. COLEMAN, S. R. FRANKS, GEORGE B. SALOVICH, FRODE ANDERSEN, FRANCIS H. ROGERS, CHEMICAL BANK NEW YORK TRUST COMPANY, a New York corporation, and FIRST DOE through TENTH DOE, inclusive,

*Appellees.*

**Appeal from an Order Denying Application and Motion to File  
Complaint of the United States District Court for the  
Northern District of California, Southern Division**

**Honorable George B. Harris, Judge**

**APPELLANTS' REPLY BRIEF**

---

STARK & CHAMPLIN,

By JOHN F. WELLS,

JOHN F. BANKER,

ALFRED N. GERTMENTIAN,

1100 Financial Center Building,

Oakland, California 94612,

*Attorneys for Appellants.*

**FILED**

MAR 7 1966

WM. B. LUCK, CLERK



## Subject Index

---

	Page
I. Preliminary statement .....	1
II. Argument .....	2
A. Standard of review: evidentiary conflicts should be resolved in favor of appellants .....	2
B. The retroactivity of the LMRDA is irrelevant to the present action .....	6
C. The doctrines of res judicata and collateral estoppel are not applicable .....	8
1. The denial of a motion to amend the complaint in the Local 97 action was not an adverse ruling on the merits of the proposed amended complaint ..	8
2. An order denying leave to amend a pleading is not a "final judgment" .....	11
D. All issues of fact should have been resolved in favor of appellants .....	13
1. Scope of appellate review of factual issues ....	13
2. Union status of appellant Horner .....	14
3. The severance plan was not properly adopted..	17
4. Ratification presented a triable issue of fact ....	19
(a) Appellees failed to make full disclosure ..	19
(b) The votes were not "implied" ratifications	21
5. Exhaustion of internal union remedies .....	21
E. Statute of limitations .....	23
F. Rule 23(b) .....	25
III. Conclusion .....	25



## Table of Authorities Cited

<b>Cases</b>	<b>Pages</b>
Associated Press v. United States (1944) 326 U.S. 1, 65 S.Ct. 1416, 89 L.Ed. 2013.....	3, 14
Balboa Shipping Co. v. Standard Fruit & Steamship Co. (Cir. 2, 1950) 181 F.2d 109.....	11
Bland v. Connally (Cir. D.C., 1961) 293 F.2d 852.....	10
Chapman v. Sheridan-Wyoming Coal Company (1950) 338 U.S. 621, 70 S.Ct. 392, 94 L.Ed. 393.....	13
Cox v. American Fidelity & Casualty Co. (Cir. 9, 1957), 249 F.2d 616 .....	4
Edsberg v. Local Union No. 12 of Int. U. of Operating Eng. (9th Cir., 1962) 300 F.2d 785.....	22
Hancock Oil Co. v. Universal Oil Products Co. (Cir. 9, 1941) 120 F.2d 959.....	11
Highway Truck Drivers and Helpers Local 107 v. Cohen (E.D. Pa., 1960) 182 F.Supp. 608, aff'd 284 F.2d 162, cert. den. 365 U.S. 833.....	3, 5, 6
Holton v. McFarland (D. Alaska, 1963) 215 F.Supp. 372..	6
Hudson Distributors v. Lilly & Co. (1964) 377 U.S. 386, 84 S.Ct. 1273, 12 L.Ed.2d 394.....	13
In Re Hoover Co. (CCPA, 1943) 134 F.2d 624.....	11
Krieger v. Ownership Corporation (Cir. 3, 1959) 270 F.2d 265 .....	3
Mercantile National Bank v. Langdeau (1963) 371 U.S. 555, 9 L.Ed.2d 523, 83 S.Ct. 520.....	12
National Machinery Company v. Waterbury Farrel Foundry and Machine Company (Cir. 2, 1961) 290 F.2d 527.....	11
Nelson v. Johnson (1963) 212 F.Supp. 233.....	24
Penuelas v. Moreno (S.C. Cal., 1961) 198 F.Supp. 441.....	22
Pogue v. Great Atlantic & Pacific Tea Company (Cir. 5, 1957) 242 F.2d 575.....	4, 14

## TABLE OF AUTHORITIES CITED

iii

	Pages
Sawyer v. Pioneer Mill Company (Cir. 9, 1962) 300 F.2d 200	10
Seofani v. Miami Rare Bird Farm (Cir. 5, 1953) 208 F.2d 461 .....	9
Southern Surety Co. v. Sheldon (Cir. 9, 1929) 33 F.2d 289	10
Whitaker v. Coleman (5 Cir. 1940) 115 F.2d 305.....	3
Zampos v. United States Smelting, Refining & Min. Co. (Cir. 10, 1953) 206 F.2d 171.....	3

### Codes

California Code of Civil Procedure, Section 343 .....	23
---	----

### Statutes

Labor Management Reporting and Discovery Act of 1959 (73 Stat. 519) :	
Section 501 .....	6, 22, 23, 25
Section 501(a) .....	23
Section 501(b) .....	2, 3, 4, 5, 9

### Rules

Federal Rules of Civil Procedure:	
Rule 21 .....	12
Rule 23(b) .....	25

### Texts

1 Witkin, California Law, 660 .....	23
-------------------------------------	----



# United States Court of Appeals

## For the Ninth Circuit

---

LOUIS HORNER, JOHN L. CONNOLLY, VICTOR ROMERO, JAMES RIEMERS, and HUGH BELL  
for the benefit of THE PACIFIC COAST DISTRICT OF NATIONAL MARINE ENGINEERS' BENEFICIAL ASSOCIATION, an unincorporated association,

*Appellants,*

vs.

W. A. FERRON, HENRY A. BORELLO, W. H. BUTTRAM, ROBERT H. HORNE, C. W. JENKINS, HARRY LEWIS, R. H. ROBINSON, F. E. WALTON, C. BLACK, H. COLEMAN, S. R. FRANKS, GEORGE B. SALOVICH, FRODE ANDERSEN, FRANCIS H. ROGERS, CHEMICAL BANK NEW YORK TRUST COMPANY, a New York corporation, and FIRST DOE through TENTH DOE, inclusive,

*Appellees.*

Appeal from an Order Denying Application and Motion to File  
Complaint of the United States District Court for the  
Northern District of California, Southern Division

Honorable George B. Harris, Judge

### APPELLANTS' REPLY BRIEF

---

#### I. PRELIMINARY STATEMENT.

Nearly all of appellees' legal and factual arguments rest upon a single, critical contention: that this Court

should review the lower court's ruling as if that ruling were a judgment entered after a trial on the merits (Appellees' Brief, 8-11). Of course, the very crux of this appeal is that appellants have *not* been granted a trial on the merits of their claim; they have not even been allowed to file their complaint. The standard of appellate review to be applied in reviewing a decision entered under Section 501(b) is thus of vital importance. It is discussed first in order below.

---

## II. ARGUMENT.

### A. STANDARD OF REVIEW: EVIDENTIARY CONFLICTS SHOULD BE RESOLVED IN FAVOR OF APPELLANTS.

On appeal, an order refusing leave to file a complaint under Section 501(b) of the LMRDA should be reviewed by a standard which is *at least* as strict as that applied in reviewing an order granting summary judgment. As with the summary judgment procedure, Section 501(b) provides a method of eliminating those cases wherein no factual disputes or conflicting factual inferences are presented; and neither its legislative background nor the authorities which have interpreted it suggest that the "good cause" provision of Section 501(b) was intended to authorize the resolution of factual conflicts in advance of the filing of a complaint. To interpret that section as authorizing the resolution of factual controversies without a jury trial would pose grave constitutional questions. As stated of the summary judgment procedure, it "was not intended to [and] *cannot* deprive a litigant of, or

at all encroach upon, his right to a jury trial." (Emphasis added.)

*Whitaker v. Coleman* (5 Cir., 1940) 115 F. 2d 305, at 306.

The power conferred by Section 501(b) to refuse to permit an action to be commenced serves the same purpose as summary judgment under Rule 56 of the Federal Rules of Civil Procedure. Both are intended to eliminate, without the expense of trial, cases which involve no genuine dispute of fact. The hearing provided by Section 501(b) is "a preliminary requirement . . . intended as a safeguard . . . against harassing and vexatious litigation brought without merit or good faith." *Highway Truck Drivers and Helpers Local 107 v. Cohen* (E.D. Pa., 1960) 182 F. Supp. 608, at 622, fn. 10. Summary judgment procedure is similarly intended "to provide against the vexation and delay which necessarily come from the formal trial of cases in which there is no substantial issue of fact." *Zampos v. United States Smelting, Refining & Min. Co.* (Cir. 10, 1953) 206 F. 2d 171, at 173. See also, *Associated Press v. United States* (1944) 326 U.S. 1, 6, 65 S.Ct. 1416, 89 L. Ed. 2013; *Krieger v. Ownership Corporation* (Cir. 3, 1959) 270 F. 2d 265, at 270.

It is clear, of course, that the summary judgment procedure does not authorize a trial on affidavits of disputed factual issues. As stated in *Associated Press v. United States* (1944) 326 U.S. 1, at 6, 65 S. Ct. 1416, 89 L.Ed. 2013:

. . . Rule 56 [authorizing summary judgment] should be cautiously invoked to the end that



parties may *always be afforded a trial where there is a bona fide dispute of facts* between them. (Emphasis added.)

As stated by this Court in *Cox v. American Fidelity & Casualty Co.* (Cir. 9, 1957) 249 F. 2d 616, at 618:

When confronted with a motion for summary judgment, the trial judge must determine if there are any material factual issues that should be resolved before the trier of fact. *It is not the trial judge's function . . . to resolve those issues or to weigh the evidence.*

\* \* \* \* \*

“A litigant has a *right* to a trial where there is the *slightest doubt* as to the facts . . .” (Emphasis added.)

On appeal, the standard of review applied to an adverse decision under Section 501(b) should be the same standard which is applied to an order granting summary judgment. That standard is well-established: “In reviewing the summary judgment, we need consider only that evidence most favorable to the party *against* whom the judgment was rendered, giving that party the benefit of all favorable inferences that may reasonably be drawn from the evidence.” (Emphasis added.) *Pogue v. Great Atlantic & Pacific Tea Company* (Cir. 5, 1957) 242 F. 2d 575, at 576.

While we have urged that the standard of review applicable to the instant case should be “*at least*” as stringent as that applied in reviewing summary judgments, there is good reason for applying a far *stricter* standard to the denial under Section 501(b) of leave

to file a complaint. As discussed in our opening brief, “good cause” under Section 501(b) is merely a “preliminary requirement” to dispose of suits “brought without merit or good faith”. *Highway Truck Drivers and Helpers Local 107 v. Cohen* (E.D. Pa., 1960) 182 F. Supp. 608, at 622, fn. 10; *aff’d* 284 F. 2d 162; *cert. den.*, 365 U.S. 833. Such requirement must be met before a complaint has been filed and before discovery rights have become available to the plaintiffs. The litigation is then in an embryonic stage, the plaintiffs having had no opportunity to discover the nature of the defenses which will be asserted or the evidence which the defendants will offer. The showing of good cause required at this stage of the suit—in advance of filing a complaint—should be considerably less than the showing required to defeat a motion for summary judgment.

Appellees, on the other hand, would grant the trial court “discretion” to resolve evidentiary conflicts and choose among conflicting inferences, as if the summary hearing before him were a trial on the merits. (Appellees’ Brief, “General Rules Governing This Appeal,” p. 8-11.) Appellees would correspondingly restrict this Court’s review to an application of the substantial evidence rule, although that is a form of appellate review which assumes a trial on the merits. Appellees have wholly failed to recognize that appellants have been *denied* a trial, and that that denial is precisely what this appeal seeks to correct.

**B. THE RETROACTIVITY OF THE LMRDA IS IRRELEVANT  
TO THE PRESENT ACTION.**

Appellees contend that the cause of action stated in appellants' complaint arose prior to the effective date of the Act. (Appellees' Brief, 12-13.) Appellees rely on authorities holding that, because Section 501 of the LMRDA is not retroactive, that section does not apply to any breach of trust by a union official which occurred before September 14, 1959, the effective date of the LMRDA. See *Holton v. McFarland* (D. Alaska, 1963) 215 F. Supp. 372, 376; *Highway Truck Drivers and Helpers Local 107 v. Cohen* (E.D. Pa., 1960) 182 F. Supp. 608, 611. This contention was not suggested to the lower court, although the same argument had been advanced by appellees in the Local 97 action and rejected by the court in that action.

The crux of appellees' argument is that the complaint constitutes "an attempt to attack a plan which was in existence prior to the time the LMRDA became effective." (Emphasis added.) (Appellees' Brief, 12). Based upon this characterization of the complaint, appellees contend that its cause of action arose before the effective date of the LMRDA.

On the contrary, the complaint is plainly not "an attempt to attack a plan"; its purpose is to recover District funds improperly expended by District officials for their personal benefit. Appellants' cause of action is based upon the unauthorized *payment of union funds* by appellees into the Severance Plan, in violation of appellees' fiduciary duty to their union. The charging allegations of the complaint are quite specific:

Commencing on or about April 15, 1962, . . . defendant officials have caused funds of said District . . . to be *paid* to defendant Bank, to be held by it under the purported Severance Plan. . . . Said *payments* were and are without any valid authorization. By *causing said funds to be paid* the defendant officials have violated their fiduciary obligations to the District. . . . (Emphasis added.) (C. 67:19-25).

Appellees' improper and unauthorized misapplication of District funds has occurred each and every time appellees have paid District funds into the Severance Plan. A trustee who misuses the funds entrusted to him according to a regular and systematic plan (such as making unauthorized monthly payments of trust funds into a personal retirement plan) breaches his trust with each and every payment. It is the payment, not the plan, which violates his fiduciary obligation. It is undisputed that the payments herein commenced "on or about April 15, 1962" (C. 67:19-20); such was more than two and one-half years *after* the LMRDA became effective.

Finally, it should be noted that the District was not created until April 1, 1962. (C. 77:18-21.) It would be indeed strange if a cause of action for the misuse of District funds could arise in 1959, over two years before District came into existence.

**C. THE DOCTRINES OF RES JUDICATA AND COLLATERAL  
ESTOPPEL ARE NOT APPLICABLE.**

Appellees next argue that an order of the court in the Local 97 action barred the instant suit under principles of *res judicata*. (Appellees' Brief, 13-20.) On December 16, 1963, plaintiffs in the Local 97 action moved therein for leave to file an amended complaint alleging, *inter alia*, substantially the same violations of trust respecting misapplication of District funds as are alleged in the instant action. Said amendment would have brought District, the National Union and several District officials into the Local 97 action as defendants (I R. 3:1-5.) This motion to amend was denied. (C. 64-9.) The order so denying the motion, appellees contend, was a final "adjudication on the merits that the plaintiffs were not entitled to any relief against District" (Appellees' Brief, 15); they urge it therefore barred the instant action.

Appellees are wrong. The order denying amendment was based not on the merits but on procedural grounds unrelated to the merits, such being the only objections raised to it by District. (I R. 15:15-23.) Moreover, that order was an interlocutory, non-appealable order, not a final judgment. Our position is set forth below.

**1. The Denial of a Motion to Amend the Complaint in the Local 97 Action was Not an Adverse Ruling on the Merits of the Proposed Amended Complaint.**

The objections raised by District to the motion to amend the complaint were based upon procedural grounds, wholly collateral to the merits of the proposed amended complaint (I R. 15:15-23; 10:4-11:23).



The argument in opposition to the amendment was based primarily on two procedural grounds, the alleged failure of plaintiffs to request District to take action as required by Section 501(b) and their alleged failure to exhaust administrative remedies. The brief filed by District stated:

(1) *No request or demand for court action or any other action has in fact been made upon this proposed defendant or its governing board or its officers by plaintiffs, or any of them, in connection with the subject matter of said proposed First Amended Complaint;*

(2) *Plaintiffs' remedies within this proposed defendant union have not been exhausted in connection with the same subject matter; and (Emphasis added.)*

The motion to amend was denied without comment. (I R. 4:14-17.) That denial cannot be regarded, for res judicata purposes, as a ruling on the merits. As stated in *Scrofani v. Miami Rare Bird Farm* (Cir. 5, 1953) 208 F.2d 461, at 464:

. . . We think that the rule enunciated in *West Coast Life Ins. Co. v. Merced Irr. Dist.*, 9 Cir., 114 F.2d 654, 661, certiorari denied 311 U.S. 718, 61 S.Ct. 441, 85 L.Ed. 467, is applicable to the facts of our case and effectively disposes of appellee's argument. The court in that case said: "Where a number of grounds for dismissal of an action are urged, an order of a court simply that the cause be dismissed, without an indication as to the ground upon which the court acted, cannot be res judicata of all possible grounds for such order."



It is clear that a judgment of dismissal based on a failure to exhaust administrative remedies is not res judicata on the merits. In *Bland v. Connally* (Cir. D.C., 1961) 293 F.2d 852, at 855, it was held that a judgment of dismissal grounded on the plaintiff's failure to exhaust administrative remedies prior to bringing suit was not a bar to the commencement of a subsequent suit on the same cause of action, following the exhaustion of such administrative remedies.

As stated in the Restatement of Judgments, §54:

Where a judgment is rendered for the defendant on the ground of the non-existence of some fact essential to the plaintiff's cause of action, the plaintiff is not precluded from maintaining an action after such fact has subsequently come into existence.

This Court similarly held, in *Southern Surety Co. v. Sheldon* (Cir. 9, 1929) 33 F.2d 289, at 290, that the appropriate disposition of an action prematurely brought is dismissal *without* prejudice; and this Court expressly rejected the contention that dismissal of a premature action should be with prejudice so as to bar a subsequent suit on the same cause of action. To the same effect, see *Sawyer v. Pioneer Mill Company* (Cir. 9, 1962) 300 F.2d 200, at 202 (dismissal for failure to join necessary party).

In short, the principle of res judicata would be inapplicable here (even if the ruling involved were a final judgment) because "The authorities are uniform to the effect that a question cannot be res judicata in view of a prior decision unless the issue

therein was determined on its merits.” *In Re Hoover Co.* (CCPA, 1943) 134 F.2d 624, at 628.

**2. An Order Denying Leave to Amend a Pleading is Not a “Final Judgment.”**

In *National Machinery Company v. Waterbury Farrel Foundry and Machine Company* (Cir. 2, 1961) 290 F.2d 527, 528, an order refusing to permit an amended answer asserting permissive counterclaims was held non-appealable, with the following comment:

By refusing to permit the defendant to assert the claims in this suit, the court did not decide or reflect upon the merits. It merely forced the defendant to institute new proceedings in the same or in another forum where the plaintiff could be served. Cf. *Thompson v. Broadfoot*, 2 Cir., 1948, 165 F.2d 744 [denial of motion for permissive intervention held non-appealable].

See also, *Hancock Oil Co. v. Universal Oil Products Co.* (Cir. 9, 1941) 120 F.2d 959, at 960 (“The order denying leave to file the amendment to the answer obviously was not a final order so as to be appealable”); *Balboa Shipping Co. v. Standard Fruit & Steamship Co.* (Cir. 2, 1950) 181 F.2d 109, at 110 (Order denying proposed amendment to libel against United States alleging facts to include another public vessel of United States held not a final order).

With respect to an analogous ruling respecting the exclusion of parties, the Supreme Court has held that denial of a motion to intervene is not an appealable order:

Ordinarily, in the absence of an abuse of discretion, no appeal lies from an order denying leave

to intervene where intervention is a permissive matter within the discretion of the court. *United States v. California Co-op. Canneries*, 279 US 553, 556, 73 L ed 838, 841, 49 S Ct 423. *The permissive nature of such intervention necessarily implies that, if intervention is denied, the applicant is not legally bound or prejudiced by any judgment that might be entered in the case.* He is at liberty to assert and protect his interests in some more appropriate proceeding. Having no adverse effect upon the applicant, the order denying intervention accordingly falls below the level of appealability. (Emphasis added.) *Railroad Trainmen v. Baltimore & O.R. Co.* (1946) 331 U.S. 519 at 524, 91 L. Ed. 1646, 67 S.Ct. 1387.

An order denying an application to add new defendants is “permissive” in the sense that it is addressed to the discretion of the court. Rule 21 of the Federal Rules of Civil Procedure grants broad discretion to the trial court in ruling on such applications:

Parties may be dropped or added by order of the court on motion of any party or of its own initiative at any stage of the action and on such terms as are just.

Finally, not one of the cases cited by appellees to support their contention that the denial of leave to amend was “a final, appealable order” (Appellees’ Brief, 15) involves either a motion to amend or a motion to bring in additional parties. *Mercantile National Bank v. Langdeau* (1963) 371 U.S. 555, 9 L. Ed. 2d 523, 83 S. Ct. 520, involves the appealability

of a venue order; *Hudson Distributors v. Lilly & Co.* (1964) 377 U.S. 386, 389 fn. 4, 84 S.Ct. 1273, 1276 fn. 4, 12 L. Ed. 2d 394, 397 fn. 4, states that the mere presence of unresolved issues in the state courts does not make a decision of the highest state court non-final and non-appealable. *Chapman v. Sheridan-Wyoming Coal Company* (1950) 338 U.S. 621, 70 S.Ct. 392, 94 L.Ed 393, involves no apparent issue as to appealability or finality of an interlocutory order.

---

**D. ALL ISSUES OF FACT SHOULD HAVE BEEN RESOLVED  
IN FAVOR OF APPELLANTS.**

**1. Scope of Appellate Review of Factual Issues.**

Appellees claim that four disputed factual issues were presented to the lower court: (1) Whether appellant Horner was a member in good standing of District; (2) whether Local 97 authorized the Severance Plan at the outset; (3) whether payments into the Severance Plan were ratified by District; and (4) whether appellants exhausted their internal union remedies. The lower court, appellees argue, *could* have accepted appellees' evidence on one or more of these issues in ruling as it did; and, under appellees' version of the standard of appellate review herein, "if there is anything in the record to sustain the exercise of discretion by the District Court, the order appealed from must be sustained." (Appellees' Brief, 20.)

Appellants contend, on the contrary, that the District Court had no power to resolve disputed issues of fact in connection with the motion before it, but that,

as in the case of a motion for summary judgment, the parties should "always be afforded a trial where there is a bona fide dispute of facts between them." *Associated Press v. United States* (1944) 326 U.S. 1, at 6, 65 S.Ct. 1416, 89 L. Ed. 2013. Hence, as in the case of a summary judgment, appellate review should "consider only that evidence most favorable to [appellants], giving [appellants] the benefit of all favorable inferences that may be drawn from the evidence." *Pogue v. Great Atlantic & Pacific Tea Company* (Cir. 5, 1957) 242 F.2d 575, at 576.

The following discussion assumes that this Court will review all issues of fact presented below as if this were an appeal from an order granting summary judgment.

## **2. Union Status of Appellant Horner.**

Appellees contend that appellant Horner's union membership had lapsed (Appellees' Brief, 23-24) because, they claim, Mr. Horner failed to make payments in respect of a dues increase which had become effective just 15 days before the hearing in the lower court. (II R. 6:3-7.) Appellees contend, apparently, that the referendum vote authorizing this increase applied to pensioners, such as Mr. Horner, as well as to active members; and that Mr. Horner's failure to pay additional dues within the 15-day period caused the automatic loss of both his union membership and his standing to participate in this action.

Appellants' evidence, however, showed that Mr. Horner had paid his full yearly District dues in ad-



vance—prior to the increase—for the entire calendar year 1965. (II R. 5:24-25.) The receipt for those dues, duly executed on behalf of the District, was introduced in evidence. (II R. 21:19-22:9.) As of April 15, 1965, the hearing date, Horner's dues were *overpaid*, even if the increase were applicable to him. (II R. 6:23-7:9.)

Appellants adduced further evidence that the dues increase did not apply to Horner because he was retired; the increase applied only to active union members (II R. 6:15-7:23). It was undisputed that District had not notified its retired members that the increase applied to them (II R. 6-7).

It was undisputed that at least five of the six plaintiffs are members in good standing of District.

The point was thin at best; in the face of conflicting evidence it can hardly be relied upon to support the lower court's ruling. The evident function of appellees' argument is to renew several collateral contentions which they frequently asserted below: That because appellants are "dissidents," (I R. 20, 22) and because certain appellants have a retired or inactive status, their claims are less worthy of trial. Quite apart from their immateriality, these contentions imply a grossly misleading picture of the affairs and internal relationships of the Marine Engineers' union and of appellants' role in that union.

As for the assertion that appellants are "dissident union members" we can only say that they are of course dissident. It is dissidence, not harmony, that makes lawsuits. It was, of course, to protect "dissident



union members" that Congress enacted the LMRDA, based on a legislative determination that the grievances of such members were frequently meritorious and deserving of trial.

Appellees' other collateral point, that because certain appellants have retired from the sea, they can have no further legitimate interest in the affairs of their union (Appellees' Brief, 24) is utter nonsense. This is a union of seagoing engineers; and engineers at sea cannot go to union meetings. There is consequently "minimal continuity of attendance at meetings" on the part of the active members of District. (C. 114:11-23.) For this reason, the active seagoing members of the union are those *least* able to supervise the activities of union officials.

Only retired or inactive members, with an interest in their union, can follow the affairs of such a union from one meeting to the next. The interest of appellants in their union derives, quite naturally, from a long and devoted participation in union affairs. As stated by Mr. Horner:

I have been continuously a member of one or another of the local branches or subordinate associations of the National Marine Engineers for the past 40 years. . . . I have participated actively in the affairs of Local 97 for many years, having held elective office, and having served on various committees. I am 72 years of age; I stopped going to sea in July, 1954 and I have attended most of the meetings of Local 97 since then. (C. 23:26-32.)

Thus the retired or inactive member of *this* union is likely to be the *only* member who observes that repre-

sentations made by officials in 1956 are proven false by facts disclosed in 1961. The mere fact that he is retired does not make him the less outraged at flagrant misconduct by the officials of his union.

### 3. The Severance Plan was Not Properly Adopted.

Appellees next argue that there was evidence that *Local 97* authorized the participation of *its* officials in the Severance Plan; appellees contend that such evidence would support a decision that District did likewise. (Appellees' Brief, 24-28.) The only evidence which appellees cite is Resolution No. 327, which states that, "Whereas a pension program has been established for [the rank and file] \* \* \* an independent and separate retirement plan shall be established for the full time Union Officials." (C. 29.) Appellees argue that the District Court could have concluded, from "modern common experience" (Appellees' Brief, 25) that "retirement plan" as used in Resolution No. 327 is a term sufficiently broad as to encompass severance benefits. Appellees not only failed to adduce evidence below as to what "retirement plan" was intended to mean in connection with the specific resolution at issue; appellees did not even present to the lower court any evidence of "modern common experience."

In fact, the evidence which *was* offered below on this issue amply demonstrated that Resolution No. 327 did *not* authorize a Severance Plan. On its face, Resolution No. 327 says nothing about severance benefits; it merely expresses an intent to establish a retirement program for union officials comparable to that available to the rank and file, but "independent and

separate from the Pension Plan to which shipping companies contribute." (C. 29.) Appellants' evidence showed that the membership of Local 97 believed that Resolution No. 327 authorized an officials' plan substantially identical to that available to the rank and file (C. 24:21-28).

Appellees nevertheless contend that "modern common experience" (Appellees' Brief, 25)—no evidence of which was adduced below—should override the specific intent of the Local 97 membership at the time of passing Resolution No. 327. The "modern common experience" to which appellees allude is that of sophisticated lawyers, as reflected in a Prentice-Hall looseleaf service. (Appellees' Brief, 25-28.) Such experience is unlikely to be that of marine engineers; and it is highly improbable that the membership of Local 97, having recently obtained a "retirement program" *not* including severance benefits, would construe "retirement program" as used in Resolution No. 327, as one which *would* include severance benefits.

Again, a triable issue of fact, at the very least, was presented; and it should have been tried.

It should be further noted that the issue in *this* case was whether *District* ever authorized *its* officials to pay *District* funds into the Severance Plan, not whether Local 97 officials were guilty of misconduct. The propriety of paying District funds into the plan should be determined on the basis of the authority or lack of it secured by appellees from District; and Resolution No. 327 was a resolution of Local 97, not of District.

#### 4. Ratification Presented a Triable Issue of Fact.

Appellees' contention below that several votes taken within District amounted to a "ratification" of the Severance Plan (C. 103-104) was challenged on two distinct factual grounds. First, appellants demonstrated, by uncontradicted evidence, that appellees had not made the full disclosure which is essential to the effective ratification of a breach of trust. (113-119.) Second, appellants' evidence showed that the votes—none of which was by its terms a direct ratification or endorsement of the Severance Plan—were not intended by the membership to imply approval of the Plan itself. (C. 113:15-21.) The lengthy argument in Appellees' Brief (28-37) fails to come to grips with either of these factual issues.

##### (a) Appellees failed to make full disclosure.

Appellees' position respecting disclosure is quite simple: they contend that their duty of disclosure was discharged by *appellant Horner*. (Appellees' Brief, 36-37.) Thus appellees assert that "Horner has not been impeded from asserting his views" and that the members voted "with Horner's version of the facts before them" (Appellees' Brief, 36). This argument has a fundamental defect: it is appellees, not appellants, who carried the fiduciary duty of full and honest disclosure. The uncontradicted evidence adduced below as to the representations of *appellees*—that is, what *they* said to the membership respecting the plan—was as follows:

No defendant has ever made a full and honest disclosure to the membership of the invalid

nature of the Severance Plan or of the basis for plaintiffs' objection to it. On the contrary, *defendants have consistently represented to the membership that the Plan was properly authorized*; said representation has been false; and *it has been that representation which has induced the membership to vote as they have*. (Emphasis added.) (C. 114).

The minutes of the Wilmington Branch Meeting state that, following Horner's presentation, appellee Ferron "took issue" with Horner's statements. (C. 80, Ex. E.)

The positions of the parties may be demonstrated by this example: T, a trustee responsible for managing trust funds for beneficiaries A, B, C and D, is charged by beneficiary A with misapplication of funds. In response, T calls a meeting of all beneficiaries, at which he permits A to state his claims. T then informs the beneficiaries—falsely—that his actions were duly authorized by the provisions of the trust indenture, an elaborate and abstruse document which no beneficiary, except A, has ever read. A is permitted to rebut by denying that the indenture says what T has represented; A is, in short, "not impeded from asserting his views." T closes with several derogatory comments on A's age, experience and mental capacity; and beneficiaries B, C and D vote to approve T's actions (after all, T is their trustee; A is, as T says, a "dissident"). Is the ratification effective? Appellees would say yes; appellants vigorously urge that it is not.



Appellants' evidence that appellees have "consistently represented to the membership that the Plan was properly authorized . . . and that it has been that representation which has induced the membership to vote as they have." (C. 114:17-19), plainly gave rise to a triable issue of fact on the question of disclosure.

(b) The votes were not "implied" ratifications.

Furthermore, none of the votes relied on by appellees was a vote to ratify the Plan. (C. 80 and Exhibits.) They were, in the main, votes that the union *not sue its officials* for violation of Section 501. A decision not to sue is obviously not synonymous with a determination that no cause of action exists. Appellees offered no evidence to show that these votes should be construed as implying approval of the Severance Plan. Appellants, however, adduced evidence that the votes did *not* imply such a ratification. (C. 113.)

Whether the votes implied a ratification of the Plan itself or merely an unwillingness to bring suit was, at the very least, a further question of fact which should have been tried.

## 5. Exhaustion of Internal Union Remedies.

Appellees correctly state that appellants devoted "a good portion of their Opening Brief" to the subject of exhaustion. (See Appellants' Opening Brief, 23-23.) We did so because we believe the lower court based its ruling on an incorrect view that suits under Section 501(b) are subject to an exhaustion require-



ment, in apparent reliance on *Penuelas v. Moreno* (S.C. Cal., 1961) 198 F.Supp. 441. We sought to demonstrate in our opening brief that the *Penuelas* decision is wrong and has been generally repudiated.

Appellees contend that even if *Penuelas* is wrong, exhaustion "is still a factor which may be considered in the exercise of discretion by the District Court on whether good cause [under Section 501] exists." (Appellees' Brief, 37.) The contention is wholly unsupported by the authority cited for it. The case which appellees cite, *Edsberg v. Local Union No. 12 of Int. U. of Operating Eng.* (9th Cir., 1962) 300 F.2d 785, 787, 788, did not purport to construe section 501; the excerpt from *Edsberg* quoted by appellees deals with Section 101 of the LMRDA, not Section 501. Suits under Section 101 are made subject to an exhaustion requirement by the specific terms of the Act.

Next appellees argue that a referendum could have been secured by appellants. Thus they state:

. . . while appellants claim that calling a referendum is discretionary with the District Executive Committee, appellant Horner's own testimony indicates the simple procedure utilized by a member to obtain a referendum on another issue.

Appellees' Brief, 38-39.

The fact that the District Executive Committee may on one occasion have acceded to a member's request for a referendum (to increase dues) (II R. 10:22-11:16) does not in any sense demonstrate that *appellants* could have secured a referendum merely by asking for it. It is undisputed that the District by-laws,

Article VI, Section 5(1) confer on the *District Executive Committee* the exclusive right to grant—or deny—referendum votes. That Committee is, of course, comprised largely of appellees themselves. (C. 115:8-14.) Appellants have formally requested that the Committee take appropriate action to secure the return of the Severance Plan contributions. (C. 68:17-19.) Appellees—the Executive Committee—have done nothing. (I R. 44:4-14.)

---

#### E. STATUTE OF LIMITATIONS.

Appellees' argument that the lower court's order may be sustained on grounds of the statute of limitations (Appellees' Brief, 39-41) is extremely far-fetched.

First, the limitations period applicable to suits for breach of fiduciary obligations is four years under California law, not three years as stated by Appellees. California's "catch-all" statute of limitations, California Code of Civil Procedure, Section 343—a four-year statute—controls suits "to enforce trusts" and "to enforce the trustee obligations of other fiduciaries." 1 Witkin, *California Law*, 660.

A suit under Section 501 is a suit to enforce a fiduciary obligation. Section 501(a) states that "the officers . . . of a labor organization occupy *positions of trust* in relation to such organizations. . . ." It has been repeatedly stated that Section 501 imposes federally enforceable *fiduciary obligations* on union officials.

The principles stated in Section 501(a) were drawn from the Restatement of Agency in an effort to incorporate the whole body of common law precedents defining the fiduciary obligations of agents and trustees with such adaptations as might be required to take into account "the special problems and functions of a labor organization." \* \* \* Cox, *Internal Affairs of Labor Unions Under the Landrum-Griffin Act*, 58 Mich. L. Rev. 819, 828 (1960).

See,

*Nelson v. Johnson* (1963) 212 F. Supp. 233, at 240.

Second, each unauthorized payment made by appellees created a new and distinct cause of action with a new limitations period. As argued at length above, in connection with the non retroactive nature of the Act, it is unauthorized *payments* at which this action is directed; the bare execution of the Severance Plan by Local 97 officials would hardly provide grounds for this suit, despite the lack of authority therefor, had appellees not proceeded to pay *District funds* into that plan.

Third, appellees at no time asserted the statute of limitations in the lower court. While they did move to dismiss the Local 97 action on grounds, *inter alia*, of the statute of limitations (the motion was denied), they did not make a like claim in the instant case.

Finally, the complaint seeks recovery for *District* of *District funds* misappropriated by *District* officers. District was not created until April 1, 1962; appel-

ants' application to file this complaint was made on March 31, 1965, or within three years of the creation of District. Appellants' cause of action could hardly have accrued, as appellees claim, in July, 1961, nearly a year before District came into being.

---

#### F. RULE 23(b).

It seems obvious that the substantial body of rules respecting exhaustion of internal union remedies—and not Rule 23(b)—controls the pleading requirements in suits brought on behalf of a union under section 501 of the LMRDA. The point is fully discussed in our opening brief, pages 35-37.

---

### III. CONCLUSION.

This action has substantial merit and it should be tried. The Local 97 action, involving the unauthorized diversion of Local 97 funds into the identical severance plan, is now at issue; it has withstood the defendants' motion to set aside the good cause order and their further motion to dismiss; it will be tried. Why the lower court came to a different conclusion in the present case is wholly obscure. At oral argument, the court itself stated that "I think the case inevitably has to be tried," (I R. 24:17-18) and succinctly articulated the reasons for a trial on the merits:

... it's a type of a case that inevitably has to be aired in court and subjected to the cross-examination and the usual formalities that we engage in

in the determination of factual issues, and I would be reluctant to pass upon a motion for summary judgment envisioning or attempting to envision, at least, the issues as I see them tendered to the Court. I think it would be most insecure in the Court of Appeals. They might make very short work of it, and what would it profit us to go up to the Court of Appeals and come back and have to retry it? I think it would be far better to try the case and get it over with. Somebody is right and somebody is wrong. (I R. 25:11-23.)

We submit that the lower court's comments were quite appropriate; this is indeed a case "that inevitably has to be aired in court and subjected to the cross-examination and the usual formalities that we engage in in the determination of factual issues. . . ."

We respectfully submit that the order of the lower court should be reversed.

Dated, Oakland, California,  
March 2, 1966.

Respectfully submitted,

STARK & CHAMPLIN,

By JOHN F. WELLS,

JOHN F. BANKER,

ALFRED N. GERTMENIAN,

*Attorneys for Appellants.*

## CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

JOHN F. WELLS,  
*Attorney for Appellants.*





Nos. 20,117, 20,118 and 20,119

IN THE  
United States Court of Appeals  
For the Ninth Circuit

MADE RITE INVESTMENT Co.,  
*Petitioner,*

vs.

COMMISSIONER OF INTERNAL REVENUE,  
*Respondent.*

No. 20,117

MADE RITE TRANSPORTATION Co.,  
*Petitioner,*

vs.

COMMISSIONER OF INTERNAL REVENUE,  
*Respondent.*

No. 20,118

MADE RITE MANUFACTURING Co.,  
*Petitioner,*

vs.

COMMISSIONER OF INTERNAL REVENUE,  
*Respondent.*

No. 20,119

BRIEF FOR PETITIONERS

WAYNE HEA,  
HEA AND ANDERSON,  
25 Taylor Street,  
San Francisco 2, California,  
*Attorneys for Petitioners.*

FILED

OCT 4 1965



## Subject Index

---

	Page
Jurisdiction .....	2
Made Rite Investment Co. ....	2
Made Rite Transportation Co. ....	2
Made Rite Manufacturing Co. ....	3
Statement of the case .....	4
Statement of facts .....	5
Specification of error .....	21
Statutes and regulations involved .....	22
Summary of argument .....	22
Argument .....	23
Conclusion .....	50

---

## Table of Authorities Cited

Cases	Pages
Aldon Homes, Inc., 33 T.C. 582.....	40
Bonneville Locks Towing Co., Inc., et al. v. United States, D.C.W.D.W., 1963, 63-2 U.S.T.C. 9782.....	23, 24, 39
Bush Hog Manufacturing Co., Inc., et al., 42 T.C. No. 52 (1964) .....	34
Fine Realty Co., Inc. v. U. S., 209 F. Supp. 286, 10 AFTR 2d 5751 .....	49
Hawaiian Trust Company, Ltd. v. United States, 291 F. 2d 768 .....	25
James Realty Co. v. United States, 280 F. 2d 394.....	23

	Pages
Kessmar Construction Co. v. Comm., 336 F. 2d 865, 14 AFTR 2d 5597 .....	35
Kessmar Construction Co., 39 T.C. 778.....	23
Maxwell Hardware Co. v. Comm. (March 30, 1965), 65-1 U.S.T.C. 9332 (9th Cir.) .....	42
National Investors Corp. v. Hoey (C.A. 2), 144 F. 2d 466..	43
United States v. U. S. Gypsum Company (1948), 333 U.S. 364 .....	36

### Codes

#### Internal Revenue Code of 1954:

Section 11(c) .....	23
Section 162(a) .....	50
Section 269 .....	4, 23, 24, 25, 39, 42
Section 269(a) .....	23
Section 269(a)(1) .....	23
Section 302 .....	39
Section 337 .....	39
Chapter 1, Subchapter S:	
Section 1371 .....	48
Section 1372(a) to (d) .....	48

### Regulations

Revenue Regulations, Section 1.269-3(a) .....	25
---	----

### Texts

7A Mertens, Section 42.228 .....	25
----------------------------------	----







Nos. 20,117, 20,118, 20,119

IN THE

**United States Court of Appeals  
For the Ninth Circuit**

---

---

MADE RITE INVESTMENT Co.,  
*Petitioner,*

vs.

COMMISSIONER OF INTERNAL REVENUE,  
*Respondent.*

No. 20,117

---

MADE RITE TRANSPORTATION Co.,  
*Petitioner,*

vs.

COMMISSIONER OF INTERNAL REVENUE,  
*Respondent.*

No. 20,118

---

MADE RITE MANUFACTURING Co.,  
*Petitioner,*

vs.

COMMISSIONER OF INTERNAL REVENUE,  
*Respondent.*

No. 20,119

---

**BRIEF FOR PETITIONERS**

---

This is an appeal from three decisions of the Tax Court of the United States rendered on January 21, 1965, and reported at 41 T.C. No. 75.

## **JURISDICTION**

### **Made Rite Investment Co.**

The appeal of petitioner, Made Rite Investment Co., (hereinafter called Investment), involves Federal income taxes for the calendar years 1956, 1957, 1958 and 1959. On September 27, 1961, the Commissioner of Internal Revenue mailed to Investment a Notice of Deficiency (R. 11-16). Within ninety days, petitioner, Investment, filed a Petition with the Tax Court of the United States for a redetermination of the deficiency for income taxes (R. 1-65). On February 6, 1962, respondent filed an answer to the petition (R. 66-68). The decision of the Tax Court, determining deficiencies against Investment for the calendar years 1956, 1957, 1958 and 1959 in the respective amounts of \$20,072.00, \$7,911.55, \$5,675.55 and \$5,675.55 was entered on January 21, 1965 (R. 269). The case was brought to this Court by a Petition for Review filed April 12, 1965 (R. 287-294), pursuant to Sections 7482 and 7483 of the Internal Revenue Code of 1954. Petitioner's tax returns here involved were filed with the District Director of Internal Revenue at San Francisco, California.

### **Made Rite Transportation Co.**

The appeal of petitioner, Made Rite Transportation Co., (hereinafter called Transportation), involves Federal income taxes for the calendar years 1956, 1957, 1958 and 1959. On September 27, 1961, the Commissioner of Internal Revenue mailed to Transportation a Notice of Deficiency (R. 78-83). Within ninety days, petitioner, Transportation, filed a Peti-

tion with the Tax Court of the United States for a redetermination of the deficiency for income taxes (R. 67-131). On February 6, 1962, respondent filed an answer to the petition (R. 132-133). The decision of the Tax Court, determining deficiencies against Transportation for the calendar years 1956, 1957, 1958 and 1959 in the respective amounts of \$17,780.94, \$8,732.94, \$5,664.95 and \$6,879.52 was entered on January 21, 1965 (R. 276). The case was brought to this Court by a Petition for Review filed April 12, 1965 (R. 295-301), pursuant to Sections 7482 and 7483 of the Internal Revenue Code of 1954. Petitioner's tax returns here involved were filed with the District Director of Internal Revenue at San Francisco, California.

**Made Rite Manufacturing Co.**

The appeal of petitioner, Made Rite Manufacturing Co., (hereinafter called Manufacturing), involves Federal income taxes for the calendar years 1958 and 1959. On September 27, 1961, the Commissioner of Internal Revenue mailed to Manufacturing a Notice of Deficiency (R. 143-147). Within ninety days, petitioner, Manufacturing, filed a Petition with the Tax Court of the United States for a redetermination of the deficiency for income taxes (R. 134-195). On February 6, 1962, respondent filed an answer to the petition (R. 196-197). The decision of the Tax Court wherein said Court determined an overpayment of \$3,823.60 to be due the petitioner, Manufacturing, for the year 1958, and wherein the Tax Court determined a deficiency of \$6,053.66 to be due from the petitioner,

Manufacturing, for the year 1959, was entered on January 21, 1965 (R. 285-286). The case was brought to this Court by a Petition for Review filed April 12, 1965 (R. 302-307), pursuant to Sections 7482 and 7483 of the Internal Revenue Code of 1954. Petitioner's tax returns here involved were filed with the District Director of Internal Revenue at San Francisco, California.

---

#### **STATEMENT OF THE CASE**

There are two issues involved in this appeal.

1. Was the principal purpose for the organization of the three petitioner corporations, rather than a single corporation, the avoidance of income taxes by securing the benefit of additional surtax exemptions, and were three of the surtax exemptions properly disallowed by the Tax Court under Section 269 of the Internal Revenue Code of 1954.

2. Was the Tax Court correct in its determination of the amounts representing reasonable compensation paid to officers and employees of petitioner Investment during 1956 and 1957 and was the Tax Court correct in its determination of the amounts representing reasonable compensation to one of the officers of petitioner Transportation during 1956 and 1957.

### STATEMENT OF FACTS

Commencing about 1930, Dillier and others were engaged in the business of manufacturing, processing and selling frankfurters, luncheon meats and other sausage products, as well as hams and bacon, as a partnership under the name of Made Rite Sausage Company (hereinafter sometimes called the partnership). Between 1930 and 1955 there was a substantial growth in the business of the partnership (R. 214).

Either at the same time that Johnson acquired his interest or at some other undisclosed time prior to 1949, Curnow, Halter and Kaelin each acquired an interest in the partnership equal to that of Johnson. In 1949, Johnson, Curnow, Halter and Kaelin purchased additional interests in the partnership from Dillier, so that thereafter each of the five partners owned an equal one-fifth interest. The partnership was operated under written "Articles of Copartnership" dated February 26, 1949 (R. 215).

After the five individuals became equal partners, their respective duties were as follows: Curnow was in charge of sales; Halter was in charge of production; Kaelin was the meat buyer, and also was in charge of the fresh meat operations and the maintenance of the plant and refrigeration equipment; Johnson was in charge of office and clerical functions, credit and collections, advertising, bookkeeping, purchasing of packaging supplies, and labor relations; and Dillier was the general manager of the entire operation. Commencing about 1955, Dillier took a less



active role in the partnership business, his duties becoming advisory in nature, while Johnson assumed more of the general managerial duties (R. 215).

Thores Johnson, who was in charge of the accounting was first employed by the Made Rite Sausage Co. (a co-partnership) in the year 1930. At that time he was 24 years of age (Tr. 20). At the time of his employment by the partnership, he had had no corporate accounting experience. He was hired initially as a bookkeeper. He later became office manager and then later, in 1942, acquired a partnership interest (Tr. 21).

The main plant and offices of the partnership were located in a building or buildings owned by it at 3353 Second Avenue, Sacramento, California. The city block in which the property was located consisted of 14 or 15 lots. By 1955, the partnership owned nine of the lots and portions of two others (R. 215).

The meat products processed by the partnership were sold under the name "Made Rite Camellia Brand." Sales were made to grocery stores and other retail outlets in the northern two-thirds of California by driver-salesmen employed by the partnership covering regularly assigned routes. The driver-salesmen made sales to their customers directly from the trucks. Small quantities of certain other products, such as cheese, purchased by the partnership from other producers, were also sold by the driver-salesmen. In addition, small amounts of fresh meats were sold directly from the plant.

During the calendar years 1948 through 1954, the net income of the partnership and each partner's share of such income were as follows:

Year	Partnership Net Income	Dillier	Johnson, Halter, Curnow and Kaelin, Each
1948	\$244,248.69	\$135,693.73	\$27,138.74
1949	221,584.00	44,316.80	44,316.80
1950	191,904.00	38,380.80	38,380.80
1951	226,049.46	45,209.89	45,209.89
1952	275,341.90	55,068.38	55,068.38
1953	260,091.05	52,018.21	52,018.21
1954	231,453.96	46,290.79	46,290.79

(R. 216.)

In the mid-Fifties the partners began to realize that they were faced with certain important financial and non-financial problems in connection with their business, the Made Rite Sausage Co. (a co-partnership) (Tr. 23). One of the prime problems was that the Made Rite organization operated in partnership form and such partnership had a very large net worth (Tr. 23). By 1955 the partnership had grown to where it had annual sales of approximately \$7,-000,000 and employed assets in the partnership business of over \$2,000,000. It employed some 200 employees (Tr. 21).

Another problem existing at that time was the advancing age of most of the partners and the possibility of death from among them. Joseph Dillier was approximately 63 years of age, Frank Halter and Clarence Curnow were approximately 56, Fred Kaelin was approximately 55 and Thores Johnson was ap-

proximately 49. The partnership had had two deaths during preceding years and these deaths had caused financial problems to the firm. The financial problems had been lessened to a certain extent because of substantial amounts of insurance then carried on the lives of the decedent partners by the remaining partners. Also the firm was much smaller at that time (Tr. 23). However, from these prior deaths the partners were aware they would have to secure funds, in the case of a partner's death, with which to purchase a decedent's interest in the business and to provide the widows and dependents with money to live on, when such widows and dependents are not producing any income for the firm (Tr. 23).

At this time the partners became aware of how difficult it was to pay off, out of their annual earnings, the promissory notes they individually owed to Joseph Dillier (Tr. 23). These notes the individual petitioners had given to Joseph Dillier as part of the purchase price of their equal partnership interests which they had purchased from Joseph Dillier previously (Tr. 23). These notes also created estate liquidity problems for the debtor partners (Tr. 25). In 1954, when Joseph Dillier saw the vulnerability of the obligations owed by the remaining partners to him, he requested that the remaining four other partners each take out \$50,000 principal amount of insurance (a total of \$200,000 principal amount of life insurance) on their own lives in order to protect him in connection with the \$200,000 debt which they owed him on

the purchase price of their partnership interests which they had acquired from him. In the early part of 1955, the four partners, other than Joseph Dillier, each carried \$10,000 of insurance on their lives to protect the four partners as among themselves (Tr. 45). The insurance which Joseph Dillier required the remaining partners to take out in 1954 on their own lives in order to protect him in connection with the \$200,000 debt which they owed him on the purchase price of their partnership interest was kept in effect for four years and then, because the corporate arrangement made it possible for the remaining partners to borrow from the bank to pay off the obligation they owed Joseph Dillier, said insurance was cancelled (Tr. 45).

In 1954, Thores Johnson had his own personal estate analyzed to determine methods available to discharge his liability in regard to the promissory notes he owed to Joseph Diller, in the event of Thores Johnson's untimely death (Tr. 25).

Another problem was that in the early 1950's the meat industry was changing from a bulk-type industry to a consumers industry. This latter operation required additional amounts of capital for machinery so as to be able to automate (Tr. 32). Since none of the partners except Joseph Dillier had any independent assets, i.e., assets which they personally owned and not used in the Made Rite operations they were reluctant to have their entire personal fortunes tied up in this one partnership (Tr. 32).

In addition to the above, in the early and mid-Fifties the meat industry was having a difficult time, with many of the local California firms going out of business, (Tr. 38 and Tr. 39), due to increasing competition in California from national meat firms.

Another problem was the fact that one of the partners owed, but was unable to pay, certain financial obligations in regard to his recent divorce (Tr. 37).

While operating in partnership form it became apparent that the matter of expense and other accounting allocations were becoming an increasing problem. This was because the operating heads (who are also partners) of the separate divisions of the business objected to certain expense allocations on the basis that they were merely bookkeeping entries and did not reflect the true results of the operation of his department (Tr. 33).

On or about March 10, 1954, Thores Johnson, on behalf of the other partners and himself, solicited a sale and leaseback arrangement of the plant with the Equitable Life Assurance Company for the purpose of creating a capital fund with which to pay off Joseph Dillier (Tr. 27-28, R. 205). During the year 1956, Thores Johnson continued to seek a sale and leaseback arrangement for the Sacramento meat packing plant, land and building owned by Made Rite Investment Co. (R. 204). During the year 1957, Thores Johnson continued to seek a sale and leaseback arrangement for the Sacramento meat packing plant, land and building, owned by Made Rite Investment



Co. (R. 205). Throughout all the years covered by this tax case, Made Rite Investment Co. has been attempting to sell or sell and lease back the real property (Tr. 190).

In the years 1954 and 1955 Thores Johnson attempted to research and to determine what could be done to solve the above problems. He talked to other business people, discussed it with the partnership's banker and accountant, read material on it and discussed it with other people in the meat packing industry (Tr. 24). Thores Johnson felt that a solution to some of the above problems could be had through the creation of four corporations out of the existing Made Rite partnership. He felt that placing the real estate in one corporation would provide a secured source of fixed income for death or retirement purposes. In addition, the valuable truck fleet could be placed in a second corporation—also to provide a fixed income. He felt that in the event of the death of a partner, it might be possible to have the partners' surviving heirs retain their shares in these two fixed income corporations. Also, it was felt that it might be possible to sell either of these two groups of assets and thus provide a source of funds with which to furnish cash for the needs of a partner's heirs (Tr. 29 and Tr. 30).

In the spring of 1955, Thores Johnson, on behalf of the partners, consulted with their banker, Malland L. Madland, President of the Capitol National Bank of Sacramento, to determine said banker's reaction to Thores Johnson's idea of creating four corporations



out of the partnership. The consultation was necessary because the Made Rite partnership owed the bank money and because future borrowings would likely be made by the new corporations (Tr. 28 and Tr. 29). Malland L. Madland felt that the creation of four corporations was the only practical solution to the problems connected with the possible death of one or more of the partners and the partners' existing indebtedness (Tr. 265 and Tr. 266). On or about August 9, 1955, Malland L. Madland wrote a memo to his head office in regard to the four corporations (Tr. 268).

Prior to incorporation the idea of several corporations was also discussed with an insurance man by the name of Gilbert Schwarz (Tr. 48).

It was felt that splitting the assets up into different corporations would help limit liability in case of adverse financial circumstances. Separate corporations, it was felt would help insulate liability in connection with the large capital investment requirements necessitated by the changeover of the industry from a bulk-type industry to a consumers industry and the large capital investment required by the latter (Tr. 32 and Tr. 39). Also, it was felt that any one or more of the three operations other than sales could be disposed of and the sales organization still continue in business if the competition forced them into that position (Tr. 39 and Tr. 40).

The matter of the four corporations was discussed with the company's accountant shortly after the mat-

ter was discussed with the banker in the early spring of 1955 (Tr. 47).

The matter of the tax implications of the four corporations versus one was taken into consideration in the same manner as any other aspect of the incorporation. Taxes were not a significant factor nor a decisive factor in their decision. The taxpayers had no assurance that the corporations were going to make an income of \$25,000 a year. In fact some of them lost money in certain of the years involved in this tax controversy (Tr. 202).

In the middle or the late part of June, 1955, the decision was made to set up four corporations (Tr. 48) and Thores Johnson requested his accountant, William Himmelmann, Jr., to recommend an attorney to handle the incorporation of the four corporations. The accountant, William Himmelmann, Jr., recommended an attorney whom Thores Johnson did not know nor had not met (Tr. 271). Later Thores Johnson asked William Himmelmann, Jr. to contact the recommended attorney and arrange for an appointment. After this contact the attorney went to Sacramento and met with the five partners. There was no consultation with the attorney prior to June, 1955 (Tr. 48). Shortly after that the Articles of Incorporation for the four corporations were filed (Tr. 272).

The three petitioner corporations, and the other related corporation, Made Rite Sausage Co. (herein called Sausage) are corporations organized under the laws of the State of California (R. 213-214).

California corporate franchise tax returns for the years 1956 through 1959 were timely filed on behalf of each of the four Made Rite corporations and the taxes due thereon were timely paid (R. 233).

By a deed executed on May 4, 1961, and recorded on June 1, 1961, Investment acquired from an unrelated person another parcel of real property in the block in which the main plant was located (R. 237).

The Made Rite Transportation Co. has sold all of its transportation equipment and the corporation has been liquidated (Tr. 189). In 1962, the truck fleet was sold and leased back and this corporation liquidated (Tr. 30). Prior to 1955, the partnership attempted to work out a sale and leaseback of the trucks, but found it impractical. Because of the detailed cost figures maintained by the separate transportation corporation, it was possible to work out a satisfactory lease arrangement in 1962 after a trial basis which had started in 1960 (Tr. 30 and Tr. 31).

Certain of the stockholders of the Made Rite corporations have disposed of some of the promissory notes received at the time of incorporation, on a non-pro rata basis, to certain of their relatives; that is, notes were given in one or two of the corporations but not all four (Tr. 247 and Tr. 278).

In connection with the partner who owed certain financial obligations in regard to his divorce settlement, banker Malland L. Madland, President of the Capitol National Bank of Sacramento, had advised that the bank would advance funds on secured notes

on the real property in the real estate corporation in order that among other things, this partner could dispose of some of these notes in payment of said marital obligations (Tr. 37).

The accounting on a separate corporation arm's-length basis has resulted in some of the corporations showing losses, some corporations showing moderate profits and some showing very satisfactory profits, depending upon their actual results of operations (Tr. 34). The net income (or loss) of the Made Rite corporations for the years 1956 through 1959, as shown on the returns filed for those years, was as follows:

	1956	1957	1958	1959
Sausage	\$100,401.42	\$57,609.51	\$ 37,922.00	\$ 73,162.91
Manufacturing	39,661.29	(57,757.27)	17,842.62	160,419.10
Investment	18,288.87	55,020.57	54,255.37	31,149.49
Transportation	30,133.25	33,695.23	41,531.81	57,513.89
Totals	\$188,484.83	\$88,568.04	\$151,551.80	\$322,245.39

(R. 235.)

The Tax Court held that the principal purpose for the organization of the four Made Rite corporations, rather than a single corporation, and the acquisition by the partners of all of the stock of those corporations was to avoid Federal income tax by securing the benefit of three additional surtax exemptions, which would not otherwise have been available (R. 238).

During the years 1956 through 1959, Dillier, Kaelin, Curnow, Johnson and Halter were paid compensation by the four Made Rite corporations as follows:

1956	Sausage	Manufac- turing	Transpor- tation	Invest- ment	Total
Dillier	\$ 2,000	0	\$23,800	0	\$ 25,800
Kaelin	0	\$ 25,800	0	0	25,800
Curnow	25,800	0	0	0	25,800
Johnson	0	0	0	\$25,800	25,800
Halter	0	25,800	0	0	25,800
Totals	\$27,800	\$ 51,600	\$23,800	\$25,800	\$129,000
<b>1957</b>					
Dillier	\$ 6,800	\$ 6,800	\$ 6,400	\$ 4,800	\$ 24,800
Kaelin	0	24,800	0	0	24,800
Curnow	24,800	0	0	0	24,800
Johnson	9,520	11,520	1,760	1,760	24,560
Halter	0	24,800	0	0	24,800
Totals	\$41,120	\$ 67,920	\$ 8,160	\$ 6,560	\$123,760
<b>1958</b>					
Dillier	\$ 9,240	\$ 18,720	\$ 400	0	\$ 28,360
Kaelin	7,160	21,200	0	0	28,360
Curnow	28,360	0	0	0	28,360
Johnson	13,560	15,120	160	0	28,840
Halter	3,000	25,360	0	0	28,360
Totals	\$61,320	\$ 80,400	\$ 560	0	\$142,280
<b>1959</b>					
Dillier	\$ 6,240	\$ 18,720	0	0	\$ 24,960
Kaelin	4,160	30,300	0	0	34,460
Curnow	29,960	4,750	0	0	34,710
Johnson	10,400	24,310	0	0	34,710
Halter	0	34,960	0	0	34,960
Totals	\$50,760	\$113,040	0	0	\$163,800

The amounts so paid were claimed as deductions on the returns filed by the respective corporations (R. 233-234).

On its 1956 and 1957 income tax returns, Investment claimed deductions of \$34,009.80 and \$6,560, respectively, representing compensation paid as follows:

	1956	1957
Thores Johnson	\$25,800.00	\$1,760.00
Joseph Dillier	—	4,800.00
Geneva Hayhurst	5,238.00	—
Chester Brewster	2,916.80	—
M. Schoenbacker	55.00	—
Totals	\$34,009.80	\$6,560.00

(R. 235. A.).

Geneva Hayhurst had been employed by the partnership in 1941 as a bookkeeper. She had taken a bookkeeping course in high school and had worked as a bookkeeper for another sausage company prior to being employed by the partnership. During 1956 she was the office manager for the four corporations, but received compensation only from Investment. Her duties included supervision of the office services for all four corporations and keeping the books for Sausage and Manufacturing. The bulk of her work was concerned with the business of Sausage, with only a small portion of her time being devoted to the affairs of Investment. The books of Investment and Transportation were kept by another bookkeeper in the office. Investment paid no other office salaries during the years 1956 through 1959, nor did it claim a deduction for any office expenses on its returns for those years. During 1957, 1958 and 1959, Geneva Hayhurst received no compensation from Investment. The record does not indicate which of the other Made Rite corporations paid her salary for those years (R. 236). The salary for Miss Hayhurst was in effect a method



of allocating office costs and bookkeeping costs and office space and machinery and personnel salary. It was felt that if one employee was assigned to this corporation and that employee's salary paid by Made Rite Investment Co. that this salary would be a reimbursement for these above-mentioned expenses of this corporation (Tr. 163).

Chester Brewster had been the night watchman for the partnership and continued to perform the same function after the four corporations took over the **business**. His duties were to guard the main plant building, title to which was transferred to Investment during 1956, as well as the property belonging to the other Made Rite corporations located on the plant premises, including trucks, title to which was in Transportation, and machinery and inventory, which were listed as belonging to Manufacturing. Schoenbacker acted as night watchman for one week during 1956 while Brewster was on vacation. The amounts paid by Investment during 1956 to Brewster and Schoenbacker were the only amounts paid by any of the Made Rite corporations for the services of night watchmen during that year. During 1957, 1958 and 1959, the night watchmen employed in the Made Rite business received their entire compensation from Manufacturing (R. 236). Made Rite Investment Co. paid Chester Brewster \$2,916.80 for services rendered during the year 1956. He was employed as a night watchman, security officer, to guard the plant during the night hours (Tr. 166).

A salary of \$23,800.00 was paid to Joseph Dillier by Made Rite Transportation Company for the year 1956 (Tr. 174). Joseph Dillier had driven a truck in this meat operation at the inception of the company for some ten years. He had as a driver of a truck operated a sales route. He was assigned the responsibility in 1956 of the supervision, maintenance, repairs and operation of the truck fleet owned by Made Rite Transportation Company. In addition, he was responsible for the construction of bodies of the trucks and of the buying of new trucks and facilities. He also was to pursue the matter of the sale and leaseback of the entire fleet of trucks (Tr. 174 and Tr. 175). The salary arrangement made with Joseph Dillier for 1956 was a contractual arrangement made by the Board of Directors of Made Rite Transportation Company (Tr. 175 and Tr. 176). In 1957, Joseph Dillier was paid \$6,400.00 for services rendered to the Made Rite Transportation Company (Tr. 174). The salary of Joseph Dillier for the year 1957 was reduced based upon experience gained during the year 1956. The salary was reduced to the time and effort which it was anticipated would be put in by Joseph Dillier in 1957 based on the experience of 1956 (Tr. 175).

Thores Johnson, for the year 1956, was paid the sum of \$25,800 as compensation for services rendered to Made Rite Investment Co. (Tr. 160). The salary was established on the basis that Thores Johnson would be devoting most of his time to the Investment Company with the idea of endeavoring to secure a

sale of the assets of the Investment Company. Salaries were set on the basis of the expected duties and activities of an executive and what he would be most likely to concern himself with during the ensuing year (Tr. 162). Thores Johnson worked on sale and leaseback arrangements for the plant during the year 1956 (Tr. 179). Thores Johnson devoted substantially all of his time to the Made Rite Corporations (Tr. 197 and Tr. 198). He had some outside interests which he took care of mainly after working hours, weekends and vacation time. During the five preceding years prior to the incorporation of the four corporations, Thores Johnson had earned approximately \$40,000 to \$60,000 per year (Tr. 169). In 1957, Thores Johnson was paid \$1,760.00 for services rendered to Made Rite Transportation Company (Tr. 174). The salary of Thores Johnson for the year 1957 was reduced based upon experience gained during the year 1956. The salary was reduced to the time and effort which it was anticipated would be put in by Thores Johnson in 1957 based on the experience of 1956 (Tr. 175).

The Tax Court held that reasonable compensation for services rendered to Investment by its officers and employees during 1956 was as follows: Thores Johnson, \$1,760; Geneva Hayhurst, \$500; Chester Brewster, \$1,200; M. Schoenbacker, \$25. Reasonable compensation for services rendered to Investment by its officers and employees during 1957 was as follows: Thores Johnson, \$1,760; Joseph Dillier, \$500; and that reasonable compensation for services rendered to Transportation by Dillier during the years 1956

and 1957 did not exceed \$500 for each of those years (R. 238).

---

### **SPECIFICATION OF ERROR**

It is petitioners' position that the Tax Court erred in determining that the principal purpose for the organization of the petitioner corporations was to avoid Federal income tax by securing the benefit of additional surtax exemptions which would not otherwise have been available. Further, it is petitioners' position that the finding of the Tax Court that the principal purpose for the organization of the petitioner corporations was to avoid Federal income tax by securing the benefit of additional surtax exemptions which would not otherwise have been available is contrary to the evidence of the case and the uncontradicted testimony of petitioners' witnesses.

It is also petitioners' position that the Tax Court erred in its determination of what was reasonable compensation for services rendered to Investment by its officers and employees during 1956 and further that the Tax Court erred in its determination of what was reasonable compensation for services rendered to Transportation by one of its officers during the years 1956 and 1957.

## **STATUTES AND REGULATIONS INVOLVED**

All of the Statutes and Regulations cited herein are set forth in full in the Appendix hereto.

---

## **SUMMARY OF ARGUMENT**

The uncontradicted facts and testimony of this case show that the principal purpose for the organization of the petitioner corporations was not to avoid Federal income tax by securing the benefit of additional surtax exemptions which would not otherwise have been available, but rather, that the controlling and principal purpose for their organization was to provide a flexible financial and corporate arrangement to aid in providing a large amount of funds for the current and retirement needs of the five major stockholders and to provide funds and/or income for the latter's heirs in case of a death. For the foregoing cash funds, of over \$1,000,000, to be realized and distributed to the shareholders it took until 1964, but the pre-incorporation business reasons were there, they were acted upon in good faith and they did materialize. In addition to the foregoing principal business reasons for the organization of petitioner corporations there were other business reasons which the incorporators held in good faith. Most of those subsidiary business reasons also were realized.

The compensation paid by petitioners Transportation and Investment in 1956 and 1957 and disallowed by the Tax Court were paid under compensation arrangements entered into by unrelated parties, in



good faith, and based upon their best estimate of the situation at the time of making the compensation contracts. The compensation disallowed was not a disguised dividend nor was it paid for any other reason (nor did the Commissioner so claim), but to compensate the persons involved for services rendered during the applicable years. The compensation thus paid should be allowed as a tax deduction to Transportation and Investment for the years involved.

---

### ARGUMENT

In imposing the surtax on the taxable income of a corporation, Section 11(c) of the Code provides an exemption of \$25,000. In Section 269(a), it is provided that if a person or persons acquire control of a corporation and the principal purpose of such acquisition is evasion or avoidance of Federal income tax by securing the benefit of a deduction, credit, or other allowance which such person or corporation would not otherwise enjoy, then the deduction, credit, or allowance shall not be allowed. For the purposes of Section 269(a)(1), control is defined as the ownership of stock possessing at least fifty per cent of the total combined voting power of all classes of stock entitled to vote.

Acquisition of control, as used in Section 269, includes the formation of new corporations. *James Realty Co. v. United States*, 280 F. 2d 394; *Kessmar Construction Co.*, 39 T.C. 778.

Petitioners cite the case of *Bonnerille Locks Towing Co., Inc., et al., v. United States*, D.C.W.D.W.,



1963, 63-2 U.S.T.C. 9782, at 90,094, giving illustrations, examples and a definition of the phrase "principal purpose" of Section 269 of the Internal Revenue Code of 1954:

"The jury may consider the importance of a 'purpose' even though that purpose was a personal reason of the stockholder of the corporations.

Evidence concerning a plan of the stockholders of the plaintiffs legally to reduce the estate taxes, which would come due upon their deaths, may be considered by the jury. A 'purpose' to minimize estate taxes is in no way connected with a 'purpose' to minimize corporate income taxes by securing a credit it would not otherwise enjoy.

The phrase 'principal purpose' does not mean that the formation of a corporation must have been motivated solely for the reason of acquiring an additional surtax exemption. All that is required is that the purpose of acquiring an additional surtax exemption outranked or exceeded in importance other business reasons for the formation of the corporation.

As a general proposition a taxpayer has a right to separate various phases of his business into separate entities and to combine them as he sees fit and has no obligation to adopt a course which carries a greater tax burden. However, if the principal purpose of a taxpayer in reorganizing his business into separate corporate divisions is to avoid or reduce federal tax liability, under the law the taxpayer may not claim or have the benefit of such avoidance or reduction of tax liability.

The prohibited purpose of tax evasion or avoidance must be the 'principal' purpose of the taxpayer in reorganizing his business into separate corporations. However, mere consideration of tax consequences in such a reorganization in itself does not necessarily render it a principal purpose of the taxpayer."

"The prohibition imposed by law is the acquiring control of a corporation if that acquisition is for the principal purpose of evasion or avoidance of Federal income tax. The principal purpose of the acquisition does not become evasion or avoidance merely because tax consequences were considered." *Security Homes, Inc., et al. v. United States*, D.C. N.D., 1963, 63-1 U.S.T.C. 9297, at 87,730.

In order for Section 269 to apply, the purpose to evade or avoid income tax must have been the principal purpose for the formation of the petitioner corporations here involved. The following quotation from *Mertens*, 7A Section 42.228 cited with approval by the Ninth Circuit Court of Appeals, in *Hawaiian Trust Company, Ltd. v. United States*, 291 F. 2d 768, makes the point clearly:

"The prohibited purpose of tax evasion must be the 'principal' purpose, and the principal purpose of a transaction does not become tax evasion merely because its tax consequences are considered by the parties to the transaction."

The Regulations Section 1.269-3(a) provides that tax evasion or avoidance purposes must be the principal purpose for establishing a corporation and that

the tax avoidance purposes must exceed in importance any other purpose.

The Tax Court found and so stated:

“We are convinced, from our study of the record, that the alleged business objectives did not in fact motivate the organization of the multiple corporations. The one purpose of apparent substance was the obtaining of the additional surtax exemptions of which Johnson had cognizance.” (R. 253).

Petitioners submit that the uncontradicted evidence of the case shows that prior to Johnson becoming aware of the tax consequences he had generally decided upon the four corporations subject to further checking to see if there were any substantial reasons against going ahead with such a plan. At Tr. 29 Johnson stated “In the spring of 1954, I had about come to the conclusion that the only thing for us to do was to form a corporation, for a variety of reasons, and that the best arrangement would be to divide the organization into four corporations, and I discussed this with Mr. Madland, and he advised me that he thought it was an excellent plan and that it would enhance the lending ability of the bank and we would still have available to us bank financing funds.”

Mr. Madland was the President of the Capitol National Bank of Sacramento. At the time of the trial he was retired and an unbiased witness. His testimony was uncontradicted. His testimony is set out below in full because of its importance concerning the intent with which petitioners were created (Tr. 264-268):

“Direct Examination

By Mr. Hea:

Q. Mr. Madland, when did you first become acquainted with the Made Rite Sausage Company partnership?

A. 1947.

Q. When did you first become acquainted with Mr. Thores Johnson?

A. About the same time.

Q. In what connection did you become acquainted with both the Made Rite Sausage Company and Mr. Thores Johnson?

A. I handled the banking business.

Q. Were you in the banking business at that time?

A. I was.

Q. What position did you hold?

A. I was President of the Capitol National Bank of Sacramento.

Q. Have you been in the banking business a long time?

A. Well, about fifty years.

Q. Mr. Madland, did you have occasion to talk to Mr. Thores Johnson in 1955 at all?

A. Yes, I did.

Q. About when?

A. Well, it's pretty hard to pin an exact time down at this late date. It was early in 1955.

Q. Do you recall the purpose of that meeting?

A. Yes, he wanted to keep me abreast of what was going on and he laid his story of proposed incorporation before me and wanted to know what we thought of it.

Q. What type of plan did he lay before you, roughly?

A. Well, again it is hard to get into specific detail, but he proposed four corporations. The purpose of them was to insure continuity of the business in the event of the passing of one of the partners, and then there was the partners' indebtedness that we wanted to take care of.

Q. Did you ever approve this idea?

A. It seemed to me that in view of all the circumstances surrounding the case, it was the only practical answer to it.

Q. On or about August 9, 1955, did you write a memo to your head office in regard to these incorporations?

A. I probably wrote more than one, but I am sure that on or about that time I did in answer to an inquiry from them.

Mr. Hea: No further questions, Your Honor.

#### Cross-Examination

By Mr. Moore:

Q. Mr. Madland, do you recall having made a statement to Mr. Johnson that the formation of four corporations would make it easier to borrow money?

A. No, I don't recall that I said that specifically.

Q. But substantially did you say that in substance?

A. How can I tell that seven years later? I told him that I thought his plan was one that would work.

Q. What was his plan?

A. His plan was four separate corporations and the purpose of the plan was to set it up so that they could get money out of it to pay the partners' indebtedness and to insure perpetuity of the business, and it was a good business.



Q. Do you remember any details of the plan submitted to you?

A. No, I don't remember the details of it except they were borrowing on the real estate; they were borrowing on the chattels.

Q. When the plan was put up to you did it call for them to form a relatively thin corporation, with a little stock and a lot of notes to the partners?

A. No, I don't remember that it did that specifically; the capital was adequate.

Q. Did the plan include restricted stock agreements limiting the sales of stock?

A. That I don't remember.

Q. In other words, you really don't remember the details of the plan?

A. I couldn't be sure—I shouldn't be expected to either.

Q. Is there any particular reason to recollect that you talked to Mr. Johnson about these four corporations?

A. There is every reason I should remember that because that's what there were—four corporations, four.

Q. And was there any reason that you can recall why four corporations would serve functions better than one?

A. The only thing I remember is that they wanted to set up several corporations so that in the event they wanted to sell any segment of the business they would have it set up so they could.

Q. I see.

A. The plan, so you will understand it, was to allow free sale of one corporation without being required to sell part of the others. What they wanted to do was preserve the Made Rite Sausage



business as such. Now, there was nothing specific laid down as to which corporation they wanted to sell. They did mention, as I recall, a possibility of selling the real estate and leasing it back, and also the trucking end of the business. That much I do remember.

Q. Selling it to third parties?

A. Yes. Outside of the business.

Mr. Moore: No further questions, Your Honor.

Mr. Hea: No further questions.

The Court: You are excused.

(Witness excused.)"

The matter of the tax implications of the four corporations versus one was taken into consideration in the same manner as any other aspect of the incorporation. Taxes were not considered a significant factor nor a decisive factor in the decision to incorporate the petitioners. The testimony of Johnson which the Tax Court relied on so heavily in its decision is set forth following (Tr. 201-203):

Cross-Examination  
(of Mr. Johnson)

By respondent's counsel:

"Q. Mr. Johnson, you knew when these corporations were formed that there might be a tax advantage in forming four corporations rather than one; didn't you?

A. I knew that there were advantages in sur-tax exemptions. I didn't know whether they would be beneficial in this case.

Q. You knew you could gain further exemptions?

A. We thought we might; however, to offset that possibility there were increased expenses.

Q. But you did know that as far as your tax structure was concerned, additional exemptions would be allowable?

A. As far as the net income to us was concerned, we didn't think that it would make any difference.

Q. I am not talking about the net income to you. I am talking about the tax burden of the corporation business. You knew that the corporation business would get extra deductions if four corporations were formed rather than one?

A. That is right.

Q. And you took that into consideration in forming four corporations?

A. No. I think you take tax into consideration as you would any other matter.

Q. There was a significance?

A. No; this was not a decisive factor. It didn't seem to make a difference one way or another. We had no assurance that these corporations were going to make an income over \$25,000 a year; in fact, some of them have lost money over the years.

Q. But you knew that the prior earnings of the business were such that the total would likely exceed \$100,000?

A. We hoped so, or we would have gone broke very soon.

Q. Well, the prior earnings of the partnership, prior to 1955, indicated that each succeeding year had exceeded the previous year?

A. Yes.

Q. And you knew that?

A. Yes."

To further point up the fact that the surtax exemptions were not a decisive or a major factor in the decision to incorporate petitioners the uncontradicted testimony of the independent licensed public accountant, William Himmelmann who testified on cross-examination (Tr. 321 and 322), should be noted:

“By Mr. Moore:

Q. Mr. Himmelmann, how long have you been a member of the California Society of Public Accountants?

A. Let's say since 1950.

Q. Is that organization under state statute in California?

A. No, sir, it is not—You said the Society of California?

Q. Yes.

A. No, sir, it isn't.

Q. Didn't you discuss with the Made Rite owners the tax advantages of multiple corporations?

A. In that instance, Mr. Johnson called me in and asked me.

Q. You told him he could get extra exemptions if the corporations were recognized?

A. No, sir.

Q. You didn't?

A. I never told him he could get additional exemptions.

Q. You didn't?

A. No, sir.”

From the foregoing testimony and that which appears at Tr. 47 and 48 (which will be set forth below verbatim) it is apparent that Thores Johnson merely discussed the idea of the four corporations with his

accountant, who prepared the partnership's tax return, in the same general manner as he had with his banker and insurance man and not with the idea of seeking out some prohibited tax-saving scheme:

“By Mr. Hea:

Q. After you talked to your banker in the early spring of 1955, did you talk to anyone else?

A. Well, of course we discussed it with our outside public accountant.

Q. What was his name?

A. William Himmelmann.

Q. After you discussed it with Mr. Himmelmann, did you discuss the idea of the four corporations or several corporations with anyone else that you can name?

A. Well, it is rather difficult to go back for five or six years, but I do know I discussed it with an insurance man.

Q. What was the insurance man's name?

A. Gilbert Schwarz.

Q. What time in 1955 did you make up your mind to go—strike that.

What action in '55 did you take to implement these four corporations?

A. We made our decision to set up these corporations, and then I told our accountant to get an attorney who would be competent to establish these corporations and this was in about mid-June of 1955.

Q. Did your accountant contact someone?

A. Yes, he contacted an attorney in San Francisco.

Q. Prior to this contact with this attorney in June and—I mean the middle of June, 1955, had you ever consulted with that attorney in regard to the four corporations?

A. I never met the attorney or knew him until he came into our office with Mr. Himmelmann, when we met to set up these organizations in late June.

The Court: June of what year?

The Witness: 1955."

Petitioners respectfully submit that business reasons prompted their incorporation and that in checking out the feasibility of creating four corporations Thores Johnson actually did less tax investigation than the taxpayers in *Bush Hog Manufacturing Co. Inc., et al.*, 42 T.C. No. 52 (1964). In *Bush Hog Manufacturing Co. Inc., et al.*, supra, the Tax Court said at page 42-529 (42.52 P-H T.C.):

"The only evidence that tax avoidance was a purpose in forming the separate corporations is the evidence that the principal officers consulted their banker, their lawyer, and their tax adviser before proceeding with the formation of the new corporations and were advised of the possible tax benefits, and the fact that the overall tax of the nine petitioners was actually reduced by the additional surtax exemptions. However, the tax adviser confirmed the testimony of the officers that when they consulted him they had already tentatively decided to form the additional corporations. He advised them that there might be tax disadvantages as well as benefits. There is no indication that he was asked to arrange or rearrange the program in a manner that would take best advantage of the tax benefits, nor is there any indication that he suggested forming separate corporations to the officers for the tax advantages to be gained."



The Tax Court stated at page 42 of its opinion (R. 249), that

“Johnson recited a number of alleged business purposes which he claimed motivated the organization of multiple corporations. Although some of the reasons advanced were unclear, the principal ones appear to be as follows: (1) that problems potentially arising from the death of a stockholder would be reduced; (2) that labor problems would be minimized; (3) that more accurate accounting figures for each function of the business would be obtained; (4) that limited liability would be obtained for each corporation; (5) that the adoption of profit-sharing or incentive plans would be facilitated; (6) that unequal cash withdrawals by the partners would be eliminated; and (7) that the discounting of secured notes issued to the stockholders could provide funds to pay off certain personal obligations of the stockholders.

An examination of the alleged business purposes reveals their lack of substance.”

Petitioners respectfully submit that the Tax Court erred in its conclusion and finding that “an examination of the alleged business purposes reveals their lack of substance”. Petitioners further submit that this is not a mere factual determination made by the Tax Court based upon inferences drawn by said Court from the evidence, but rather is a determination which is clearly erroneous and thus the subject matter for correction by this Court. *Kessmar Construction Co. v. Comm.*, 336 F. 2d 865, 14 AFTR 2d 5597. Petitioners submit that a review of the entire evidence of this case will leave this Court with a definite and firm con-



viction that a mistake has been committed in the Tax Court's holding in regard to the multiple surtax issue of this case. *United States v. U. S. Gypsum Company*, 1948, 333 U.S. 364. In support of the foregoing statement petitioners analyze the evidence of the case as they see it.

In analyzing the testimony of Thores Johnson petitioners would like to first call attention to his educational training and experience background, which is summarized as follows:

Thores Johnson, who was in charge of the accounting was first employed by the Made Rite Sausage Co. (a co-partnership) in the year 1930. At that time he was 24 years of age (Tr. 20). At the time of his employment by the partnership, he had had no corporate accounting experience. He was hired initially as a bookkeeper. He later became office manager and then later, in 1942, acquired a partnership interest (Tr. 21). It can be seen from the foregoing that Thores Johnson had had no corporate accounting or tax training or experience which would enable him to answer in *words of art*, questions put to him as a witness at the Tax Court hearing. His answers were those of a layman, not those of a skilled tax practitioner.

The Tax Court in analyzing and explaining its interpretation of the evidence of the case first concluded,

“According to Johnson, it had been felt that, in the event of the death of a stockholder, his heirs might be persuaded to retain the stock of the corporations holding the real estate and trucks.

The benefit of this arrangement to the business would apparently be that if the heirs so decided, it would be necessary to raise cash only to acquire the decedent's stock in the sales and manufacturing companies. The purported intention to hold the real estate and trucks for this purpose is not supported by the facts, however, which show that the trucks were sold and leased back and that efforts were made by the petitioners to do the same with the real estate. No reason was given as to why the stock of separate corporations holding the real estate and trucks would be more attractive to the heirs than the stock of a single corporation conducting the entire business, except to say that the two corporations would have 'fixed income'. However, the record shows that no dividends were paid by either Investment or Transportation during the taxable years. The record further shows that the trucks provided no income except through their use in the meat packing business, which the petitioners maintain was speculative, and that the real estate did not provide a significant amount of outside income. If the heirs did not wish to retain their stock in these two corporations, Johnson testified, the real estate or trucks could be sold to raise cash to pay the heirs. No explanation is given as to why the real estate or trucks, if held in a single corporation, could not as readily have been sold to raise the needed cash." (R. 249).

In analyzing the foregoing interpretation by the Tax Court petitioners would like to first take up the matter of the death or *retirement* of a partner. In Johnson's testimony he stated that prior to incorpora-

tion they (the partners) were concerned both with the *retirement* and/or the death of a partner—not just the death and the heir problem as the Tax Court concluded (Tr. 27). In March 1954, long before incorporation, Johnson was trying to make a sale and leaseback of the \$1,000,000 plant property so as to “realize a capital fund” (Tr. 27). None of the five partners had died at this time so it is obvious that the capital fund was to provide for paying off Dillier and for retirement funds for the partners (Tr. 29). If the sale and leaseback had been made in March, 1954, the \$1,000,000 of funds would have become the property of the partners to ease their financial burdens and to release substantial funds to the partners, as the four partners other than Dillier were very concerned by the fact that almost their entire lifetime asset accumulations (Tr. 32) were locked into this large but *very local* business enterprise, which enterprise employed approximately 200 employees with annual sales of around \$7,000,000 and assets of better than \$2,000,000 (Tr. 21). From Johnson’s testimony it can be seen that there were two desired business results they wanted to obtain by keeping the real estate separate, one, creating a large capital fund from the sale and leaseback, and if a sale and leaseback were not available, then from the rental of the property a fixed income available to the partners or their heirs (Tr. 27 and 30). In 1964 Made Rite Investment Co. finally was able to arrange and complete a sale of its large plant property, liquidate and distribute to its stockholders (only one of whom had died in the mean-

time), this large capital fund, without having to pay a double tax on the sale as would have been the tax result if the plant property had been in one large corporation, had been sold therein, and an attempt made to distribute the proceeds to the living stockholders. In the latter event Section 337 of the Internal Revenue Code of 1954 would not have been available to eliminate the double tax, i.e., a capital gains tax at the corporate level and an ordinary dividend tax upon the distribution of the funds, or at the very least a second capital gains tax on the distributed funds if the individual shareholders could have met the provisions of Section 302 of the Internal Revenue Code of 1954.

It is submitted that the foregoing constitutes a proper business purpose as Section 269 of the Internal Revenue Code of 1954 was not designed to prohibit such planning. Section 269 concerns itself with the situation where

“principal purpose . . . is evasion or avoidance of Federal income tax by securing the benefit of a *deduction, credit or other allowance* which such person or corporation would not otherwise enjoy . . .”

Petitioners submit that the arranging of one's business affairs in order to provide financial flexibility such as petitioners' organizers had in mind and as detailed hereinbefore is not proscribed by Section 269 as the Tax Court's opinion in effect held. *Bonneville Locks Towing Co., Inc., et al. v. U. S.*, *supra*.

The law on the subject of a taxpayer's right and limitations to mold his business and personal financial arrangements is well stated in *Aldon Homes, Inc.*, 33 T.C. 582 and appearing at page 596:

"It is axiomatic that taxpayers have the right to mold business transactions in such a manner as to minimize the incidence of taxation, for no taxpayer is obligated to pay more tax than the law demands of him. *United States v. Isham*, 84 U.S. 496; *Gregory v. Helvering*, 293 U.S. 465; *United States v. Cumberland Public Service Co.*, 338 U.S. 451.

In *Higgins v. Smith*, 308 U.S. 473, the Supreme Court, although recognizing that '(a) taxpayer is free to adopt such organization for his affairs as he may choose,' nevertheless stated:

On the other hand, the Government may not be required to acquiesce in the taxpayer's election of that form for doing business which is most advantageous to him. The Government may look at actualities and upon determination that the form employed for doing business or carrying out the challenged tax event is unreal or a sham may sustain or disregard the effect of the fiction as best serves the purposes of the tax statute. To hold otherwise would permit the schemes of taxpayers to supersede legislation in the determination of the time and manner of taxation. It is command of income and its benefits which marks the real owner of property.

In *National Investors Corp. v. Hoey* (C.A. 2) 144 F.2d 466, 468, Judge Learned Hand pointed out that: to be a separate jural person for purposes of taxation, a corporation must engage in



some industrial, commercial, or other activity besides avoiding taxation: in other words, that the term 'corporation' will be interpreted to mean a corporation which does some 'business' in the ordinary meaning; and that escaping taxation is not 'business' in the ordinary meaning.

In *Commissioner v. Court Holding Co.*, 324 U.S. 331, 334, the Supreme Court stated: The incidence of taxation depends upon the substance of a transaction. \* \* \* To permit the true nature of a transaction to be disguised by mere formalisms, which exist solely to alter tax liabilities, would seriously impair the effective administration of the tax policies of Congress.

As was earlier stated by the Supreme Court in *Gregory v. Helvering*, *supra*, 'To hold otherwise would be to exalt artifice above reality, and to deprive the statutory provisions in question of all serious purpose.'

The above cases make it clear that a taxpayer may adopt any form he desires for the conduct of his business and that form cannot be ignored merely because it results in a tax saving. However, to be afforded recognition the form the taxpayer chooses must be a viable business entity, that is, it must have been formed for a substantial business purpose or actually engage in substantive business activity. *Moline Properties, Inc. v. Commissioner*, 319 U.S. 436; *Jackson v. Commissioner*, (C.A. 2, 1956) 233 F.2d 289. Escaping taxation is not a substantive business activity. *National Carbide Corp. v. Commissioner*, 336 U.S. 422, footnote 20, citing *National Investors Corp. v. Hoey*, *supra*."



From a reading of the foregoing case material, it can be seen that taxpayers have the right to create one or more corporations so long as the corporations are formed for a substantial business purpose and actually engage in substantive business activity. As regards Made Rite Investment Co., real property of a value of at least \$1,000,000 was placed in the corporation. A court can take judicial notice of the fact that thousands upon thousands of real property rental corporations have been created in the United States with considerably less by way of assets and considerably less by way of rental income. A court can also take judicial notice of the fact that these same thousands upon thousands of real property rental corporations have been allowed their surtax exemptions by the Internal Revenue Service where the business reasons for their incorporation were less than in the case of petitioner, Made Rite Investment Co. This petitioner should not be penalized because incident to its incorporation for justified business purposes a surtax exemption became available to it and thus a tax savings. *Marwell Hardware Co. v. Comm.*, decided March 30, 1965, 65-1 U.S.T.C. 9332, 9th Cir. The business reasons for incorporating petitioner, Made Rite Investment Co., far outweighed any tax-savings reasons proscribed by Section 269, therefore, the Tax Court's disallowance of the surtax exemption of this petitioner, for the tax years involved in this petition should be reversed.

The same evidence, reasoning and law which has been set forth in the foregoing in regard to the busi-

ness reasons for the creation of petitioner, Made Rite Investment Co., are equally applicable to Made Rite Transportation Co.; as is said evidence, reasoning and law, justification and authority for this Court to reverse the Tax Court's decision disallowing the surtax exemptions of this petitioner, Made Rite Transportation Co., for the tax years here involved in its case. The value of the trucks transferred to this corporation exceeded \$250,000. When a sale and leaseback of the trucks was found feasible, as planned these funds were distributed to the incorporators, upon the liquidation of Made Rite Transportation Co. (Tr. 189).

The same evidence, reasoning and law which has been set forth in the foregoing in regard to the business reasons for the creation of petitioner, Made Rite Investment Co., are equally applicable to Made Rite Manufacturing Co.; as is said evidence, reasoning and law, justification and authority for this Court to reverse the Tax Court's decision disallowing the surtax exemptions of this petitioner, Made Rite Manufacturing Co., for the tax years here involved in its case. The value of the meat manufacturing equipment transferred to this corporation was of an approximate value of \$750,000. From its corporate inception it employed nearly 200 employees (Tr. 21). It is submitted that this corporation certainly constitutes a viable corporation serving a truly business purpose as set forth in *National Investors Corp. v. Hoey*, (C.A. 2) 144 F. 2d 466, 468, and Judge Learned Hand pointed out that: "to be a separate jural person for purposes of taxation, a corporation must engage

in some industrial, commercial, or other activity besides avoiding taxation; in other words, that the term 'corporation' will be interpreted to mean a corporation which does some 'business' in the ordinary meaning." As Thores Johnson testified it is not uncommon in the meat industry for a manufacturer not to directly sell its products at retail and it is also not uncommon for there to be meat sales organizations which do not manufacture the products they sell (Tr. 39, 40 and 42).

As Johnson testified there were a number of other minor business objectives and factors which he felt influenced him and his associates to settle on four corporations rather than one. He discussed them briefly in his testimony (Tr. 33 to 47, inclusive). The Tax Court in its opinion treats these additional objectives and factors as major business reasons, and since a number of them had not materialized at the time of trial or had not resulted in immediate benefit to the petitioners, the Tax Court held that an examination of the alleged business purposes reveals their lack of substance (R. 249). Petitioners respectfully submit that the Tax Court is in error in so holding. The primary business purpose of the four corporations was to provide financial flexibility in providing for the retirement or death of one or more of the five original partners. This was accomplished as explained previously in this brief. The other benefits hoped to be gained were merely incidental. It must be remembered that Johnson, with his limited corporate experience and limited educational background was during the pre-incorporation period asking his associates in the

meat packing industry about corporations. It is obvious that he would be presented with many ideas by his business associates that may or may not have applicability to his firm's own situation. Johnson in good faith believed that the desired results would flow from the four corporations. A court can take judicial notice of the fact that many lay people think there is great business magic in a corporation and obviously if one corporation would give those business benefits, four should give more business benefits. It is submitted that the petitioners should not be penalized because all their business hopes and plans did not immediately materialize. It is well recognized law that a court should be reluctant to substitute its business judgment for that of the business man who is on the firing line, especially where the business man has a very limited technical and experience background and the problem to be solved is one requiring technical knowledge and experience.

The Tax Court listed seven reasons which it states were advanced by Johnson as "principal" reasons (R. 249), as follows:

(1) That problems potentially arising from the death of a stockholder would be reduced; (2) that labor problems would be minimized; (3) that more accurate accounting figures for each function of the business would be obtained; (4) that limited liability would be obtained for each corporation; (5) that the adoption of profit-sharing or incentive plans would be facilitated; (6) that unequal cash withdrawals by the partners would be eliminated; and (7) that the dis-

counting of secured notes issued to the stockholders could provide funds to pay off certain personal obligations of the stockholders.

Petitioners submit that only the first was a material business reason and that this has been accomplished as explained previously herein. Further, number seven is only a part of the other major objective, namely, providing financial means for retirement of one or more of the partners. This retirement objective, a major objective, the Tax Court has completely overlooked. The note arrangement was merely a source of funds to pay off the personal obligations owed to Dillier by the remaining four partners. The sale and leaseback of the major assets, land, building and refrigerated trucks was to provide substantial funds for all five partners and before death, as well as after death. These sales and leasebacks have been accomplished, resulting in a distribution for retirement purposes of approximately \$1,000,000 to the five incorporation shareholders.

It is submitted that as to item two Johnson honestly felt his labor position would be improved and that this is all that the law requires. A major labor catastrophe is not necessary to prove him right.

Petitioners submit that more accurate accounting figures have resulted between different functions under the control of different partners. See the differences in net profits of the various petitions (R. 235). To the lay mind separate corporations require separate accounting much, much more than would mere divisions of the same corporation. It should be remembered that it was the intention of the partners before incor-



poration that four of the five partners would each handle the activities of a separate corporation, i.e., one partner to one corporation. The fact that later experience taught them that this was not practicable should not be held against them under the tax laws. Further, the fact that it took a year or so for Johnson and the licensed public accountant (not Certified Public Accountant), to work out all the correct detailed accounting procedures should be viewed as a favorable matter on this score as it shows good faith. As they found better and more accurate accounting methods they adopted them. After the first two years of operation of petitioners, the Commissioner does not take exception to any of their accounting procedures.

Limited liability has been obtained for each corporation as to the general public even though as to the bank the latter insisted on cross-guarantees between petitioners for loans. Such bank practice is standard in California. The incorporators were able to split up some two million of assets into four separate corporations, each corporation's assets being protected from the general liabilities of the other corporation. The advanced age of these men should be remembered for at that age they would not be willing to start over but would be much more willing to salvage what they could in the event of a serious financial reverse regardless of what it might do to their long-run financial reputation—as they at that point would be retiring from active business anyway.

As to item four, the petitioners engaged an expert in 1956 (Tr. 47), to study the feasibility of any of the four corporations adopting a qualified profit-sharing



plan or qualified pension plan at that time. The expert recommended against the adoption of either a qualified profit-sharing plan or a qualified pension plan by any of the corporations. Here again petitioners should not be penalized because upon qualified advice they did not proceed. Further, before incorporation they knew as partners they could not participate in such plans (Tr. 47), and that it would only be in corporate form that they would have a chance to participate in a qualified profit-sharing or a qualified pension plan.

Unequal cash withdrawals were eliminated. All the incorporators were on fixed salaries, thus this reason did produce results (R. 234).

Item seven has previously been discussed and it did achieve its objective.

In conclusion, as to the multiple surtax issue, if the principal purpose for organizing petitioners was to obtain additional surtax exemptions, why would the shareholders voluntarily have given up three of the four surtax exemptions since petitioners were incorporated, as follows:

1. Made Rite Sausage Co.—voluntarily given up in 1958 when Sausage elected to report its income from 1958 on as a small business corporation under Subchapter S of Chapter 1, Sections 1371 and 1372(a) to (d) of the Internal Revenue Code of 1954.
2. Made Rite Transportation Co.—this corporation was dissolved and its assets distributed in 1962.
3. Made Rite Investment Co.—this corporation was dissolved and its assets distributed in 1964.

As to the compensation issue or issues involved in this appeal petitioners are of the opinion that the case of *Fine Realty, Inc. v. U. S.*, 209 F. Supp. 286, 10 AFTR 2d 5751, is in point and we quote from that opinion at page 5754:

“The first issue is as to the propriety of the deduction of \$9,000.00 for Mrs. Fine’s salary. The evidence in this regard is inconclusive. On the one hand, there was testimony by Mrs. Fine and by her husband that as president of Fine Realty, Inc., she performed valuable services for that corporation. On the other, there was testimony by employees of the taxpayer that Mrs. Fine did not perform any such services. There is evidence that Mrs. Fine did in fact perform some services for the Fine enterprises, considered collectively, although it is difficult to find that the services were for the exclusive benefit of the corporation which paid her. The Court is of the view, however, that in determining reasonableness of the salary involved it must look beyond the corporate entity, Fine Realty, Inc., to the entire structure of the Fine enterprises. This factor, along with the fact that the combined total salaries of Mr. and Mrs. Fine, as shown on their joint return for 1955, were \$54,000.00 (not a patently excessive amount), leads the Court to conclude that the salary deduction was not unreasonable and was improperly disallowed.”

Petitioners submit that for the years 1956 and 1957 the compensation paid to Dillier, Johnson, Geneva Hayhurst, Chester Brewster and M. Schoenbacker was fair and reasonable; for in the years 1958 and 1959,

the same, or greater amounts, were paid to these persons as compensation and were allowed upon audit by the Commissioner and not changed by the Tax Court when it was deciding the tax case below for those years. Petitioners respectfully urge that this Court reverse the compensation disallowances made by the Tax Court in regard to the foregoing people for the years 1956 and 1957 and allow to petitioners as a tax deduction under Section 162(a) of the Internal Revenue Code of 1954, all compensation paid to them by petitioners during the years 1956 and 1957, as a reasonable allowance for salaries or other compensation for personal services actually rendered in carrying on a trade or business.

---

### CONCLUSION

Petitioners respectfully submit that the uncontradicted evidence and testimony shows that the Tax Court erred in its conclusion and finding that the principal purpose for the organization of petitioner corporations was tax avoidance. Petitioners further submit that this is not a mere factual determination made by the Tax Court based upon inferences drawn by said Court from the evidence, but rather is a determination which is clearly erroneous and thus the subject matter for correction by this Court. *Kessmar Construction Co. v. Comm.*, supra.

As to the compensation issue involved in this appeal petitioners urge that the case of *Fine Realty, Inc. v. U. S.* should control the disposition of said compensation issue.

In view of the above it is respectfully requested that the decisions of the Tax Court be reversed as to all petitioners.

Dated, San Francisco, California,  
September 20, 1965.

Respectfully submitted,  
WAYNE HEA,  
HEA AND ANDERSON,  
*Attorneys for Petitioners.*

---

#### CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with these rules.

WAYNE HEA,  
*Attorney for Petitioners.*

**(Appendix Follows)**



## **Appendix.**





## Appendix

---

### STATUTES AND REGULATION INVOLVED

Internal Revenue Code Section 162(a)(1):

Sec. 162. Trade or Business Expenses.

(a) In General.—There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including—

(1) a reasonable allowance for salaries or other compensation for personal services actually rendered;

Internal Revenue Code Section 269:

Sec. 269. Acquisitions Made to Evade or Avoid Income Tax.

(a) In General.—If—

(1) any person or persons acquire, or acquired on or after October 8, 1940, directly or indirectly, control of a corporation, or

(2) any corporation acquires, or acquired on or after October 8, 1940, directly or indirectly, property of another corporation, not controlled, directly or indirectly, immediately before such acquisition, by such acquiring corporation or its stockholders, the basis of which property, in the hands of the acquiring corporation, is determined by reference to the basis in the hands of the transferor corporation,

and the principal purpose for which such acquisition was made is evasion or avoidance of Federal income tax by securing the benefit of a deduction, credit, or other allowance which such person or corporation would not otherwise enjoy, then the Secretary or his delegate may disallow such deduction, credit, or other allowance. For purposes of paragraphs (1) and (2), control means the ownership of stock possessing at least 50 percent of the total combined voting power of all classes of stock entitled to vote or at least 50 percent of the total value of shares of all classes of stock of the corporation.

(b) Power of Secretary or His Delegate to Allow Deduction, etc., in part.—In any case to which subsection (a) applies the Secretary or his delegate is authorized—

(1) to allow as a deduction, credit, or allowance any part of any amount disallowed by such subsection, if he determines that such allowance will not result in the evasion or avoidance of Federal income tax for which the acquisition was made; or

(2) to distribute, apportion, or allocate gross income, and distribute, apportion, or allocate the deductions, credits, or allowances the benefit of which was sought to be secured, between or among the corporations, or properties, or parts thereof, involved, and to allow such deductions, credits, or allowances so distributed, apportioned, or allocated, but to give effect to such allowance only to such extent as he determines will not result in the

evasion or avoidance of Federal income tax for which the acquisition was made; or

(3) to exercise his powers in part under paragraph (1) and in part under paragraph (2).

(c) **Presumption in Case of Disproportionate Purchase Price.**—The fact that the consideration paid upon an acquisition by any person or corporation described in subsection (a) is substantially disproportionate to the aggregate—

(1) of the adjusted basis of the property of the corporation (to the extent attributable to the interest acquired specified in paragraph (1) of subsection (a)), or of the property acquired specified in paragraph (2) of subsection (a); and

(2) of the tax benefits (to the extent not reflected in the adjusted basis of the property) not available to such person or corporation otherwise than as a result of such acquisition,

shall be *prima facie* evidence of the principal purpose of evasion or avoidance of Federal income tax. This subsection shall apply only with respect to acquisitions after March 1, 1954.

**Internal Revenue Code Section 302:**

**Sec. 302. Distributions in Redemption of Stock.**

(a) **General Rule.**—If a corporation redeems its stock (within the meaning of section 317(b)), and if paragraph (1), (2), (3), or (4) of subsection (b)

applies, such redemption shall be treated as a distribution in part or full payment in exchange for the stock.

(b) Redemptions Treated as Exchanges.—

(1) Redemptions Not Equivalent to Dividends.—Subsection (a) shall apply if the redemption is not essentially equivalent to a dividend.

(2) Substantially Disproportionate Redemption of Stock.—

(A) In General.—Subsection (a) shall apply if the distribution is substantially disproportionate with respect to the shareholder.

(B) Limitation.—This paragraph shall not apply unless immediately after the redemption the shareholder owns less than 50 percent of the total combined voting power of all classes of stock entitled to vote.

(C) Definitions.—For purposes of this paragraph, the distribution is substantially disproportionate if—

(i) the ratio which the voting stock of the corporation owned by the shareholder immediately after the redemption bears to all of the voting stock of the corporation at such time,

is less than 80 percent of—

(ii) the ratio which the voting stock of the corporation owned by the shareholder immediately before the redemption bears to all

of the voting stock of the corporation at such time.

For purposes of this paragraph, no distribution shall be treated as substantially disproportionate unless the shareholder's ownership of the common stock of the corporation (whether voting or nonvoting) after and before redemption also meets the 80 percent requirement of the preceding sentence. For purposes of the preceding sentence, if there is more than one class of common stock, the determinations shall be made by reference to fair market value.

(D) *Series of Redemptions.*—This paragraph shall not apply to any redemption made pursuant to a plan the purpose or effect of which is a series of redemptions resulting in a distribution which (in the aggregate) is not substantially disproportionate with respect to the shareholder.

(3) *Termination of Shareholder's Interest.*—Subsection (a) shall apply if the redemption is in complete redemption of all of the stock of the corporation owned by the shareholder.

(4) *Stock Issued By Railroad Corporations in Certain Reorganizations.*—Subsection (a) shall apply if the redemption is of stock issued by a railroad corporation (as defined in section 77(m) of the Bankruptcy Act, as amended) pursuant to a plan of reorganization under section 77 of the Bankruptcy Act.



(5) Application of Paragraphs.—In determining whether a redemption meets the requirements of paragraph (1), the fact that such redemption fails to meet the requirements of paragraph (2), (3), or (4) shall not be taken into account. If a redemption meets the requirements of paragraph (3) and also the requirements of paragraph (1), (2), or (4), then so much of subsection (c)(2) as would (but for this sentence) apply in respect of the acquisition of an interest in the corporation within the 10-year period beginning on the date of the distribution shall not apply.

(c) Constructive Ownership of Stock.—

(1) In General.—Except as provided in paragraph (2) of this subsection, section 318 (a) shall apply in determining the ownership of stock for purposes of this section.

(2) For Determining Termination of Interest.—

(A) In the case of a distribution described in subsection (b) (3), section 318 (a) (1) shall not apply if—

(i) immediately after the distribution the distributee has no interest in the corporation (including an interest as officer, director, or employee), other than an interest as a creditor,

(ii) the distributee does not acquire any such interest (other than stock acquired by

bequest or inheritance) within 10 years from the date of such distribution, and

(iii) the distributee, at such time and in such manner as the Secretary or his delegate by regulations prescribes, files an agreement to notify the Secretary or his delegate of any acquisition described in clause (ii) and to retain such records as may be necessary for the application of this paragraph.

If the distributee acquires such an interest in the corporation (other than by bequest or inheritance) within 10 years from the date of the distribution, then the periods of limitation provided in sections 6501 and 6502 on the making of an assessment and the collection by levy or a proceeding in court shall, with respect to any deficiency (including interest and additions to the tax) resulting from such acquisition, include one year immediately following the date on which the distributee (in accordance with regulations prescribed by the Secretary or his delegate) notifies the Secretary or his delegate of such acquisition; and such assessment and collection may be made notwithstanding any provision of law or rule of law which otherwise would prevent such assessment and collection.

(B) Subparagraph (A) of this paragraph shall not apply if—

(i) any portion of the stock redeemed was acquired, directly or indirectly, within the

10-year period ending on the date of the distribution by the distributee from a person the ownership of whose stock would (at the time of distribution) be attributable to the distributee under section 318 (a), or

(ii) any person owns (at the time of the distribution) stock the ownership of which is attributable to the distributee under section 318 (a) and such person acquired any stock in the corporation, directly or indirectly, from the distributee within the 10-year period ending on the date of the distribution, unless such stock so acquired from the distributee is redeemed in the same transaction.

The preceding sentence shall not apply if the acquisition (or, in the case of clause (ii), the disposition) by the distributee did not have as one of its principal purposes the avoidance of Federal income tax.

(d) **Redemptions Treated As Distributions of Property.**—Except as otherwise provided in this subchapter, if a corporation redeems its stock (within the meaning of section 317 (b)), and if subsection (a) of this section does not apply, such redemption shall be treated as a distribution of property to which section 301 applies.

(e) **Cross References.**—

For special rules relating to redemption—

(1) **Death Taxes.**—Of stock to pay death taxes, see section 303.

(2) Section 306 Stock.—Of section 306 stock, see section 306.

(3) Liquidations.—Of stock in partial or complete liquidation, see section 331.

## Internal Revenue Code Section 337:

Sec. 337. Gain or Loss on Sales or Exchanges in Connection With Certain Liquidations.

(a) General Rule.—If—

(1) a corporation adopts a plan of complete liquidation on or after June 22, 1954, and

(2) within the 12-month period beginning on the date of the adoption of such plan, all of the assets of the corporation are distributed in complete liquidation, less assets retained to meet claims,

then no gain or loss shall be recognized to such corporation from the sale or exchange by it of property within such 12-month period.

(b) Property Defined.—

(1) In General.—For purposes of subsection (a), the term “property” does not include—

(A) stock in trade of the corporation, or other property of a kind which would properly be included in the inventory of the corporation if on hand at the close of the taxable year, and property held by the corporation primarily for sale to customers in the ordinary course of its trade or business,

(B) installment obligations acquired in respect of the sale or exchange (without regard to whether such sale or exchange occurred before, on, or after the date of the adoption of the plan referred to in subsection (a)) of stock in trade or other property described in subparagraph (A) of this paragraph, and

(C) installment obligations acquired in respect of property (other than property described in subparagraph (A)) sold or exchanged before the date of the adoption of such plan of liquidation.

(2) **Nonrecognition with Respect to Inventory in Certain Cases.**—Notwithstanding paragraph (1) of this subsection, if substantially all of the property described in subparagraph (A) of such paragraph (1) which is attributable to a trade or business of the corporation is, in accordance with this section, sold or exchanged to one person in one transaction, then for purposes of subsection (a) the term “property” includes—

(A) such property so sold or exchanged, and

(B) installment obligations acquired in respect of such sale or exchange.

(c) **Limitations.**—

(1) **Collapsible Corporations and Liquidations to Which Section 333 Applies.**—This section shall not apply to any sale or exchange—

(A) made by a collapsible corporation (as defined in section 341 (b)), or

(B) following the adoption of a plan of complete liquidation, if section 333 applies with respect to such liquidation.

(2) Liquidations to Which Section 332 Applies.—In the case of a sale or exchange following the adoption of a plan of complete liquidation, if section 332 applies with respect to such liquidation, then—

(A) if the basis of the property of the liquidating corporation in the hands of the distributee is determined under section 334 (b) (1), this section shall not apply; or

(B) if the basis of the property of the liquidating corporation in the hands of the distributee is determined under section 334 (b) (2), this section shall apply only to that portion (if any) of the gain which is not greater than the excess of (i) that portion of the adjusted basis (adjusted for any adjustment required under the second sentence of section 334 (b) (2) of the stock of the liquidating corporation which is allocable, under regulations prescribed by the Secretary or his delegate, to the property sold or exchanged, over (ii) the adjusted basis, in the hands of the liquidating corporation, of the property sold or exchanged.

(d) Special Rule For Certain Minority Shareholders.—If a corporation adopts a plan of complete liquidation on or after January 1, 1958, and if subsection (a) does not apply to sales or exchanges of



property by such corporation, solely by reason of the application of subsection (c) (2) (A), then for the first taxable year of any shareholder (other than a corporation which meets the 80 percent stock ownership requirement specified in section 332 (b) (1)) in which he receives a distribution in complete liquidation—

(1) the amount realized by such shareholder on the distribution shall be increased by his proportionate share of the amount by which the tax imposed by this subtitle on such corporation would have been reduced if subsection (c) (2) (A) had not been applicable, and

(2) for purposes of this title, such shareholder shall be deemed to have paid, on the last day prescribed by law for the payment of the tax imposed by this subtitle on such shareholder for such taxable year, an amount of tax equal to the amount of the increase described in paragraph (1).

## Internal Revenue Code Section 1371:

### Sec. 1371. Definitions.

(a) **Small Business Corporation.**—For purposes of this subchapter, the term “small business corporation” means a domestic corporation which is not a member of an affiliated group (as defined in section 1504) and which does not—

(1) have more than 10 shareholders;

(2) have as a shareholder a person (other than an estate) who is not an individual;

(3) have a nonresident alien as a shareholder;  
and

(4) have more than one class of stock.

(b) **Electing Small Business Corporation.**—For purposes of this subchapter, the term “electing small business corporation” means, with respect to any taxable year, a small business corporation which has made an election under section 1372(a) which, under section 1372, is in effect for such taxable year.

(c) **Stock Owned by Husband and Wife.**—For purposes of subsection (a)(1) stock which—

(1) is community property of a husband and wife (or the income from which is community income) under the applicable community property law of a State, or

(2) is held by a husband and wife as joint tenants, tenants by the entirety, or tenants in common,

shall be treated as owned by one shareholder.

(d) **Ownership of Certain Stock.**—For purposes of subsection (a), a corporation shall not be considered a member of an affiliated group at any time during any taxable year by reason of the ownership of stock in another corporation if such other corporation—

(1) has not begun business at any time on or after the date of its incorporation and before the close of such taxable year, and

(2) does not have taxable income for the period included within such taxable year.

Internal Revenue Code Section 1372(a)(b)(c)(d):

Sec. 1372. Election By Small Business Corporation.

(a) Eligibility.—Except as provided in subsection (f), any small business corporation may elect, in accordance with the provisions of this section, not to be subject to the taxes imposed by this chapter. Such election shall be valid only if all persons who are shareholders in such corporation—

(1) on the first day of the first taxable year for which such election is effective, if such election is made on or before such first day, or

(2) on the day on which the election is made, if the election is made after such first day,

consent to such election.

(b) Effect.—If a small business corporation makes an election under subsection (a), then—

(1) with respect to the taxable years of the corporation for which such election is in effect, such corporation shall not be subject to the taxes imposed by this chapter and, with respect to such taxable years and all succeeding taxable years, the provisions of section 1377 shall apply to such corporation, and

(2) with respect to the taxable years of a shareholder of such corporation in which or with which the taxable years of the corporation for which such election is in effect end, the provisions of

sections 1373, 1374, and 1375 shall apply to such shareholder, and with respect to such taxable years and all succeeding taxable years, the provisions of section 1376 shall apply to such shareholder.

(c) Where and How Made.—

(1) In General.—An election under subsection (a) may be made by a small business corporation for any taxable year at any time during the first month of such taxable year, or at any time during the month preceding such first month. Such election shall be made in such manner as the Secretary or his delegate shall prescribe by regulations.

(2) Taxable Years Beginning Before Date of Enactment.—An election may be made under subsection (a) by a small business corporation for its first taxable year which begins after December 31, 1957, and on or before the date of the enactment of this subchapter, and ends after such date at any time—

(A) within the 90-day period beginning on the day after the date of the enactment of this subchapter, or

(B) if its taxable year ends within such 90-day period, before the close of such taxable year.

An election may be made pursuant to this paragraph only if the small business corporation has

been a small business corporation (as defined in section 1371(a)) on each day after the date of the enactment of this subchapter and before the day of such election.

(d) **Years For Which Effective.**—An election under subsection (a) shall be effective for the taxable year of the corporation for which it is made and for all succeeding taxable years of the corporation, unless it is terminated, with respect to any such taxable year, under subsection (e).

#### Income Tax Regulation § 1.269-3:

§ 1.269-3. Instances in which section 269(a) disallows a deduction, credit, or other allowance.

(a) **Instances of disallowance.** Section 269 specifies two instances in which a deduction, credit, or other allowance is to be disallowed. These instances, described in paragraphs (1) and (2) of section 269(a), are those in which—

(1) Any person or persons acquire, or acquired on or after October 8, 1940, directly or indirectly, control of a corporation, or

(2) Any corporation acquires, or acquired on or after October 8, 1940, directly or indirectly, property of another corporation (not controlled, directly or indirectly, immediately before such acquisition by such acquiring corporation or its stockholders), the basis of which property in the hands of the acquiring corporation is determined by reference to the basis in the hands of the transferor corporation.

In either instance the principal purpose for which the acquisition was made must have been the evasion or avoidance of Federal income tax by securing the benefit of a deduction, credit, or other allowance which such other person, or persons, or corporation, would not otherwise enjoy. If this requirement is satisfied, it is immaterial by what method or by what conjunction of events the benefit was sought. Thus, an acquiring person or corporation can secure the benefit of a deduction, credit, or other allowance within the meaning of section 269 even though it is the acquired corporation that is entitled to such deduction, credit, or other allowance in the determination of its tax. If the purpose to evade or avoid Federal income tax exceeds in importance any other purpose, it is the principal purpose. This does not mean that only those acquisitions fall within the provisions of section 269 which would not have been made if the evasion or avoidance purpose was not present. The determination of the purpose for which an acquisition was made requires a scrutiny of the entire circumstances in which the transaction or course of conduct occurred, in connection with the tax result claimed to arise therefrom. For the presumption of a principal purpose of tax evasion or avoidance, see section 269(c) and § 1.269.5.





---

IN THE UNITED STATES COURT OF APPEALS  
FOR THE NINTH CIRCUIT

---

MADE RITE INVESTMENT CO.,

Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent

---

MADE RITE TRANSPORTATION CO.,

Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent

---

MADE RITE MANUFACTURING CO.,

Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent

---

ON PETITIONS FOR REVIEW OF THE DECISIONS OF THE  
TAX COURT OF THE UNITED STATES

---

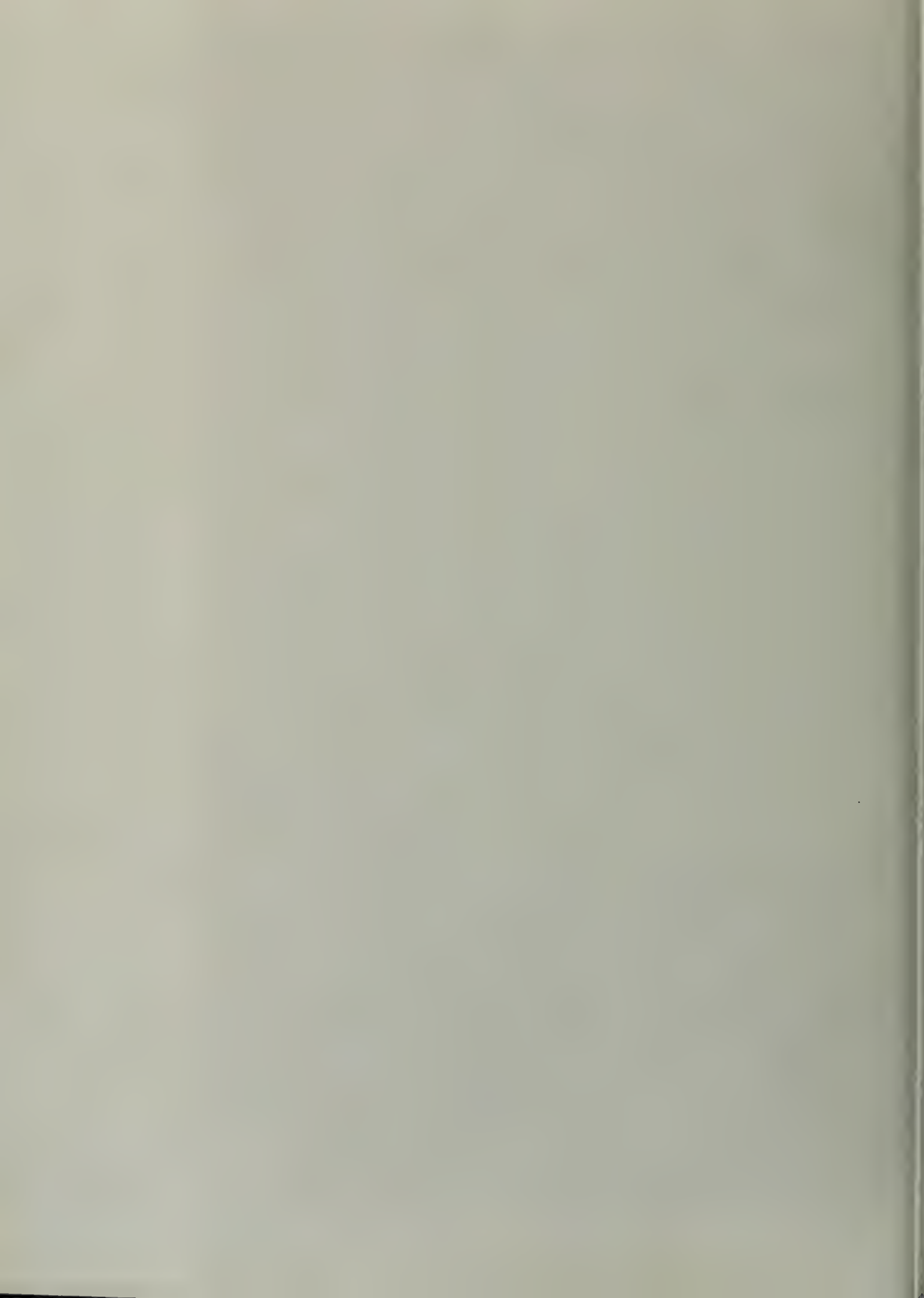
BRIEF FOR THE RESPONDENT

---

RICHARD M. ROBERTS,  
Acting Assistant Attorney General.

MEYER ROTHWACKS,  
RICHARD J. HEIMAN,  
J. EDWARD SHILLINGBURG,  
Attorneys,  
Department of Justice,  
Washington, D. C. 20530.

---



# I N D E X

	Page
Opinion below -----	1
Jurisdiction -----	2
Questions presented -----	3
Statute and Regulations involved -----	3
Statement -----	3
Summary of argument -----	18
Argument:	
I. The Tax Court correctly found that the principal purpose for the organization of the four Made Rite corporations, rather than one corporation, was to avoid tax by securing the benefit of three additional corporate surtax exemptions -----	21
A. The question of principal purpose is a question of fact; its resolution must be affirmed on review if it is supported by substantial evidence and is not clearly erroneous -----	21
B. The evidence fully supports the finding of the Tax Court -----	23
1. The operation of the corporation -----	25
2. The testimony of Thores Johnson -----	29
(a) Death of a partner-stockholder -----	31
(b) Security -----	33
(c) Accounting problem -----	34
(d) Discounting notes -----	35
(e) Unequal cash withdrawals -----	36
(f) Limited liability -----	37
(g) Labor problem -----	38
(h) Profit-sharing plans -----	39
II. The Tax Court correctly determined the amounts of deductions for compensation paid to certain officers and employees of Investment and Transportation -----	42
Conclusion -----	45
Appendix -----	46

## CITATIONS

### Cases:

<u>ABC Brewing Corp. v. Commissioner</u> , 224 F. 2d 483 -----	43
<u>Aldon Homes, Inc. v. Commissioner</u> , 33 T.C. 582 -----	25
<u>Bonneville Locks Towing Co. v. United States</u> , 343 F. 2d 790 -----	22, 41
<u>Commissioner v. British Motor Car Distributors, Ltd.</u> , 278 F. 2d 392 -----	22
<u>Commissioner v. Duberstein</u> , 363 U.S. 278 -----	23
<u>Doernbecher Mfg. Co. v. Commissioner</u> , 95 F. 2d 296 -----	42
<u>Fine Realty, Inc. v. United States</u> , 209 F. Supp. 286 ---	43
<u>E. &amp; J. Gallo Winery v. Commissioner</u> , 227 F. 2d 699 ----	44
<u>Hawaiian Trust Co. v. United States</u> , 291 F. 2d 761 -----	22
<u>Hoffman Radio Corp. v. Commissioner</u> , 177 F. 2d 264 -----	42
<u>Interstate Transit Lines v. Commissioner</u> , 219 U.S. 590 -	43, 44
<u>James Realty Co. v. United States</u> , 280 F. 2d 394 -----	22
<u>Kessmar Construction Co. v. Commissioner</u> , 336 F. 2d 865-22,23,41	45
<u>Kimball Laundry Co. v. United States</u> , 166 F. 2d 856 ----	44
<u>New Colonial Co. v. Helvering</u> , 292 U.S. 435 -----	25
<u>Shaw Construction Co. v. Commissioner</u> , 323 F. 2d 316 ---	23, 44
<u>United States v. Gypsum Co.</u> , 333 U.S. 364 -----	22
<u>Urban Redevelopment Corp. v. Commissioner</u> , 294 F. 2d 328	

### Statutes:

#### Internal Revenue Code of 1954:

Sec. 11 (26 U.S.C. 1958 ed., Sec. 11) -----	46
Sec. 162 (26 U.S.C. 1958 ed., Sec. 162) -----	46
Sec. 269 (26 U.S.C. 1958 ed., Sec. 269) -----	47
Sec. 331 (26 U.S.C. 1958 ed., Sec. 331) -----	33
Sec. 337 (26 U.S.C. 1958 ed., Sec. 337) -----	47
Sec. 341 (26 U.S.C. 1958 ed., Sec. 341) -----	48
Sec. 1231 (26 U.S.C. 1958 ed., Sec. 1231) -----	49
Secs. 1371-1377 (26 U.S.C. 1958 ed., Secs. 1371-1377) -----	4, 39

### Miscellaneous:

H. Rep. No. 586, 82d Cong., 1st Sess., p. 24 (1951-2 Cum. Bull. 357, 374) -----	21
4 Mertens, Law of Federal Income Taxation, Sec. 25.61 --	42
S. Rep. No. 781, 82d Cong., 1st Sess., p. 15 (1951-2 Cum. Bull. 458, 469) -----	21
Treasury Regulations on Income Tax :	
Sec. 1.269-3 (26 C.F.R., Sec. 1.269-3) -----	50
Sec. 1.337-1 (26 C.F.R., Sec. 1.337-1) -----	51

IN THE UNITED STATES COURT OF APPEALS  
FOR THE NINTH CIRCUIT

---

Nos. 20,117 - 20,119

MADE RITE INVESTMENT CO.,

Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent

---

MADE RITE TRANSPORTATION CO.,

Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent

---

MADE RITE MANUFACTURING CO.,

Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent

---

ON PETITIONS FOR REVIEW OF THE DECISIONS OF THE  
TAX COURT OF THE UNITED STATES

---

BRIEF FOR THE RESPONDENT

---

OPINION BELOW

The findings of fact and opinion of the Tax Court (II-R. 290-261) <sup>1/</sup>  
are officially reported at 41 T.C. 762, sub nom. Dillier v. Commissioner.

---

<sup>1/</sup> "I-R." and "II-R." references are to Volume I and Volume II, respectively, of the record on appeal; "IIA-R." references are to the transcript of proceedings contained in Volume II-A of the record on appeal.



## JURISDICTION

These petitions for review (II-R. 287-291, 295-299, 302-305) involve federal corporate income taxes. On September 27, 1961, the Commissioner of Internal Revenue mailed to the taxpayers notices of deficiency, assert the following deficiencies in income taxes (I-R. 11-16, 78-83, 143-147):

<u>Taxpayer</u>	<u>Taxable Year</u>	<u>Deficiency</u>
Made Rite Investment Co.	1956	\$20,844.20
	1957	7,911.55
	1958	5,675.55
	1959	<u>5,675.56</u>
Total		\$40,106.86
Made Rite Transportation Co.	1956	\$17,780.94
	1957	8,732.94
	1958	5,664.95
	1959	<u>6,879.52</u>
Total		\$39,058.35
Made Rite Manufacturing Co.	1956	\$ 6,053.64
	1958	4,479.03
	1959	<u>6,053.66</u>
Total		\$16,586.33

Within ninety days thereafter, on December 26, 1961, the taxpayers filed petitions with the Tax Court for redetermination of those deficiencies under the provisions of Section 6213 of the Internal Revenue Code of 1954. (I-R. 1-10, 67-77, 134-142.) The cases were consolidated for trial in the Tax Court. The decisions of the Tax Court were entered January 21, 1965. (II-R. 269, 276, 285-286.) The cases are brought to this Court by petitions for review filed April 12, 1965 (II-R. 287-291, 295-299, 302-305), within the three-month period prescribed in Section 7483 of the Internal Revenue Code of 1954. Jurisdiction is conferred on this Court by Section 7482 of that Code.

- 3 -  
QUESTIONS PRESENTED

1. Whether the finding of the Tax Court that the principal purpose for the organization of the four Made Rite corporations, rather than a single corporation, and the acquisition by the organizers of all of the stock of those corporations was to avoid federal income tax by securing the benefit of three additional corporate surtax exemptions is supported by substantial evidence in the record and is not clearly erroneous.

2. Whether the findings of the Tax Court which determined the amount of reasonable compensation paid to certain officers and employees by Made Rite Investment Company and to an officer by Made Rite Transportation Company are supported by substantial evidence in the record and are not clearly erroneous. 2/

STATUTE AND REGULATIONS INVOLVED

The pertinent statute and Regulations involved are set forth in the Appendix, infra.

STATEMENT

The pertinent facts found by the Tax Court (II-R. 213-238), some of which were stipulated (I-R. 198-200, 201-208; IIA-R. 167-168, 173), are as follows:

The events which are the subject of this litigation involve four corporations, all organized under the laws of California. The petitioners, who will be referred to collectively as the "taxpayers", are Made Rite

---

2/ The Tax Court also considered other issues involving the petitioners, including whether income reported by the Made Rite corporations during the year 1955 was actually earned by the partnership and consequently was taxable to the individual partners. The petitioners have not sought review of those determinations.

Investment Company (hereinafter referred to as "Investment"), Made Rite Transportation Company (hereinafter referred to as "Transportation"), and Made Rite Manufacturing Company (hereinafter referred to as "Manufacturing"). The fourth corporation, which participated in the litigation in the Tax Court but not on review, is Made Rite Sausage Company (hereinafter referred to as "Sausage"). The taxpayers prepared their income tax returns for the calendar years 1956 through 1959 on an accrual method of accounting and filed them with the District Director of Internal Revenue at San Francisco, California. (II-R. 213-214.) <sup>3/</sup>

I

Principal purpose for organizing  
four corporations

Commencing about 1930, Joseph Dillier and others were engaged in the business of manufacturing, processing, and selling frankfurters, luncheon meats, and other sausage products, hams, and bacon as a partnership under the name of Made Rite Sausage Company (hereinafter referred to as the "partnership"). Between 1930 and 1955, the business of the partnership grew substantially; the number of employees increased from approximately 8 to approximately 200. (II-R. 214.)

Thores Johnson was employed by the partnership in 1930 as a bookkeeper; he later became office manager. In 1942, he acquired an interest in the partnership. Either at that time or at some other time prior to 1949, Clarence W. Curnow, Frank Halter, and Fred Kaelin each acquired an interest in the partnership equal to that of Johnson. In 1949, they

---

<sup>3/</sup> Sausage filed corporate income tax returns, prepared on an accrual method of accounting, for the calendar years 1956 and 1957. By a timely election, Sausage elected to report its income as a small business corporation under Subchapter S of Chapter 1 (Sections 1371-1377) of the Internal Revenue Code of 1954, and filed small business corporation returns of income for the calendar years 1958 and 1959. (II-R. 214.)

purchased additional interests from Dillier and thereafter each of the five partners owned a one-fifth interest in the partnership. The partnership was operated under written "Articles of Copartnership" dated February 26, 1949. (II-R. 215.)

After the five individuals became equal partners, their respective duties were as follows: Curnow was in charge of sales; Halter was in charge of production; Kaelin was the meat buyer and also had charge of the fresh meat operations and the maintenance of the plant and refrigeration equipment; Johnson was responsible for office and clerical functions, credit and collections, advertising, bookkeeping, purchasing of packaging supplies, and labor relations; and Dillier was the general manager of the entire operation. Beginning in 1955, Dillier took a less active role in the partnership business and his duties became advisory in nature; Johnson assumed more of the duties of general manager. The partnership's main plant and offices were located in buildings owned by it at 3353 Second Avenue, Sacramento, California. (II-R. 215.)

The meat products processed by the partnership were sold under the name "Made Rite Camellia Brand". Sales were made to grocery stores and other retail outlets in the northern two-thirds of California by driver-salesmen employed by the partnership to cover regularly assigned routes. The driver-salesmen made sales to their customers directly from the trucks. Small quantities of other products, such as cheese, purchased by the partnership from other producers, were also sold by the driver-salesmen. In addition, small amounts of fresh meats were sold directly from the plant. (II-R. 216.)



During the calendar years 1948 through 1954, the net income of the partnership and each partner's share in such income were as follows (II-R. 216):

<u>Year</u>	<u>Partnership Net Income</u>	<u>Dillier</u>	<u>Johnson, Halter, Curnow and Kaelin, each</u>
1948	\$244,248.69	\$135,693.73	\$27,138.74
1949	221,584.00	44,316.80	44,316.80
1950	191,904.00	38,380.80	38,380.80
1951	226,049.46	45,209.89	45,209.89
1952	275,341.90	55,068.38	55,068.38
1953	260,091.05	52,018.21	52,018.21
1954	231,453.96	46,290.79	46,290.79

In March 1954, Johnson had conversations and correspondence with representatives of The Equitable Life Assurance Society regarding the possibility of a sale and lease-back transaction with that company concerning the real estate of the partnership. In July 1954, Equitable rejected the proposal. (II-R. 216.)

Sometime in 1954 or 1955, Johnson developed the idea of incorporating the business conducted by the partnership. He discussed some of the problems involved with various business people with whom the partnership dealt, including a banker, an insurance agent, and the partnership's outside public accountant. In May or June 1955, the partners decided to incorporate the business, utilizing four corporations: Made Rite Manufacturing Company would purchase meats and process them into sausage products; Made Rite Sausage Company would sell the products; Made Rite Investment Company would hold title to the real estate used in the business; Made Rite Transportation Company would hold title to the delivery trucks, refrigerator trucks, and other motor vehicles used in the business. Articles of incorporation for the four Made Rite corporations were executed by the five partners as incorporators and filed; the five partners were designated to act as the first directors of each corpora-

At the time of the incorporations, Johnson understood that three additional surtax exemptions would be available if four corporations, rather than a single corporation, were formed to take over the business of the partnership. (II-R. 217.)

According to the minutes of the respective corporations, the partners, in "Offers to Transfer Assets", purported to offer to transfer a certain portion of the partnership assets to one of the corporations, and the corporation purported to accept the offer. The consideration was to be the assumption by the corporation of certain partnership liabilities and the issuance of stock and notes to the partners. The obligation to issue the stock and notes was made subject to the corporation obtaining an appropriate permit from the Commissioner of Corporations of the State of California. (II-R. 226.)

The officers named in the corporate minutes were as follows (II-R. 225):

	<u>Sausage</u>	<u>Manufacturing</u>	<u>Transportation</u>	<u>Investment</u>
President	Curnow	Halter	Kaelin	Johnson
Vice President	Halter	Kaelin	Curnow	Halter
Secretary	Johnson	Johnson	Johnson	Kaelin
Treasurer	Kaelin	Curnow	Halter	Curnow

The Made Rite corporations were authorized to issue \$100 par value stock and notes as follows (II-R. 227):

<u>Corporation</u>	<u>Date of Permit</u>	<u>Shares of Common Stock Authorized</u>	<u>Notes Authorized</u>
Sausage	March 15, 1956	200	\$ 30,000
Investment	April 12, 1956	1,250	275,000
Manufacturing	April 12, 1956	1,100	300,000
Transportation	April 12, 1956	200	40,000



The authorized stock and the notes of each of the four corporations were issued to the five partners in equal amounts. (II-R. 228.) On the same day, the shareholders and the four corporations executed "Stock Purchase Agreements". (II-R. 228.) These agreements, identical except for the name of the corporation, provided that a stockholder, before disposing of any of his stock in the corporation during his lifetime, was required to offer to sell it first to the corporation and then to the remaining stockholders. These restrictions were not applicable to sales or gifts of the stock to children of the stockholders, but such sales or gifts could be effected only if the stockholder sold or gave to such children an equal percentage of his stock in all four Made Rite corporations. It was further provided that the stock could be bequeathed by will only to certain family members of the stockholder or could be placed in inter vivos testamentary trusts for the benefit of the family members. Otherwise, upon the death of a stockholder, the corporation had the right to purchase the stock owned by the decedent, and the remaining stockholders were required to purchase, pro rata among themselves, any of such stock not purchased by the corporation. (II-R. 226-227.)

Each of the stock purchase agreements further provided that the agreement was "mutual with and reciprocally dependent upon corresponding agreements executed this date between [the five stockholders and each of the other three Made Rite corporations] and that an election, an offer to sell, or any notice given in pursuance of those agreements shall also be considered and construed as exercising the same act under this agreement." (II-R. 227.)

Finally, each stock purchase agreement provided for the termination of the "Articles of Copartnership" dated February 26, 1949. (II-R. 227.)

The business conducted by the four Made Rite corporations in 1956 and thereafter was the same business which the partnership had previously conducted. Each of the five shareholders continued to perform the same duties which he had performed under the partnership. (II-R. 231.) All four corporations used the former office of the partnership as their office. The records for the corporations were all kept at that office and generally by the same employees. The signs on the main plant were limited to "Camellia Brand" and "Made Rite Sausage". The only listing for the business in the telephone directories was made in the name of Sausage. (II-R. 232.) Throughout 1955 and for an undisclosed period thereafter, the only stationery used in the business bore the name Made Rite Sausage Company. (II-R. 222.)

The meat products manufactured or processed by Manufacturing were sold only through Sausage, and all receipts therefrom were deposited in the Sausage bank accounts. In addition, Sausage distributed small amounts of certain products, such as cheese, purchased by the business from others, as the partnership had done previously. (II-R. 231.) The gross sales of Sausage, as shown on its returns for the years 1956 through 1959, were as follows (II-R. 231):

<u>Year</u>	<u>Gross Sales</u>
1956	\$6,586,462.06
1957	7,369,466.31
1958	8,284,965.42
1959	7,693,123.90

No inventory was recorded on the books of Sausage. The entire inventory of the business was recorded on the books of Manufacturing, and the dollar amounts of "sales" from Manufacturing to Sausage were determined by calculations made after Sausage had sold the products to customers. These calculations were made by one of two methods: One method was to take the amounts by weight of the various types of products sold by Sausage and apply thereto certain prices per pound or ton for each type; the other method was to apply percentage figures to the dollar amounts of the gross sales of Sausage. (II-R. 231.)

In 1957, Manufacturing applied to the Crocker-Angle National Bank for a line of credit in the amount of \$200,000. As a prerequisite, the bank required that Investment, Transportation, and Sausage guarantee repayment of the funds advanced to Manufacturing and that the notes payable by the four Made Rite corporations to the five stockholders be subordinated to the obligation to the bank. The boards of directors of Investment, Transportation, and Sausage authorized such guarantees, and the stockholders agreed to subordinate their notes. The bank granted the line of credit sought. (II-R. 233.)

In 1958, Manufacturing sought to increase its line of credit with the bank to \$300,000. The boards of directors of the respective corporations similarly authorized guarantees of the increased amount. (II-R. 233.)

Title to the plant and the surrounding real property was transferred by the partnership to Investment in 1956 and a first deed of trust was executed to secure the promissory notes issued by Investment to the five stockholders which totalled \$275,000. (II-R. 228.) The partnership



transferred to Sausage a warehouse and adjoining realty located at Chico, California, in 1956. (II-R. 228.) At some undisclosed time, two leases, running from Investment to Transportation and to Manufacturing, respectively, were prepared. One of these instruments purported to lease the garage and parking lot adjoining the main plant to Transportation for a five-year term at an annual rate rental of \$4,050. The other instrument purported to lease the plant itself to Manufacturing for a similar five-year term, at a total rental of \$487,000 for the five years. (II-R. 220.) In 1959 Investment acquired further property which was used by Manufacturing to house certain meat processing operations. (II-R. 233.)

All of the amounts reported as rental income on the returns filed by Investment represented intercompany payments from Manufacturing, Transportation, and Sausage, except for small amounts derived from rental of a parking lot and a few residential units to unrelated parties. (II-R. 231-232.)

In February 1956, the partnership transferred title to 30 motor vehicles to Transportation, including five executive automobiles, one each for Dillier, Curnow, Halter, Johnson, and Kaelin. At an undisclosed time an instrument entitled "Truck Lease Service Agreement" was prepared which purported to lease from Transportation certain motor vehicles to Sausage. (II-R. 220, 223.) All of the amounts reported as rental income on the returns filed by Transportation represented intercompany payments from Sausage, including payments for the five executive automobiles. No rental payments to Transportation for use of the executive automobiles were made by or accrued on the books of Manufacturing or Investment. No vehicles owned by Transportation were rented to outsiders. (II-R. 232.)

At least three labor unions represented various employees of the partnership: The teamsters union represented the driver-salesmen; the butchers' union represented certain meat processing employees; and the packers' union represented other meat processing employees. Beginning at some undisclosed time after the formation of the Made Rite corporations, labor contracts with the teamsters union were signed by Sausage, and those with the butchers' union were signed by Manufacturing. The employees of the partnership belonging to the packers' union became employees of Manufacturing, but neither the packers' union nor the association which had bargained with that union on behalf of the partnership were ever advised of the change of the employer. (II-R. 232.)

During 1954 or 1955, the approximate ages of the partners were as follows: Dillier, 63; Halter, 56; Curnow, 56; Kaelin, 55; and Johnson, 49. (II-R. 215.)

During the years 1956 through 1959, the Made Rite corporations paid the following amounts to the five stockholders as compensation and claimed them as deductions on their respective income tax returns (II-R. 233-234):

<u>1956</u>	<u>Sausage</u>	<u>Manufacturing</u>	<u>Transportation</u>	<u>Investment</u>	<u>Total</u>
Dillier	\$ 2,000	0	\$23,800	0	\$ 25,800
Kaelin	0	\$ 25,800	0	0	25,800
Curnow	25,800	0	0	0	25,800
Johnson	0	0	0	\$25,800	25,800
Halter	0	25,800	0	0	25,800
Totals	<u>\$27,800</u>	<u>\$ 51,600</u>	<u>\$23,800</u>	<u>\$25,800</u>	<u>\$129,000</u>

<u>1957</u>	<u>Sausage</u>	<u>Manufacturing</u>	<u>Transportation</u>	<u>Investment</u>	<u>Total</u>
Dillier	\$ 6,800	\$ 6,800	\$ 6,400	\$ 4,800	\$ 24,800
Kaelin	0	24,800	0	0	24,800
Curnow	24,800	0	0	0	24,800
Johnson	9,520	11,520	1,760	1,760	24,560
Halter	0	24,800	0	0	24,800
Totals	<u>\$41,120</u>	<u>\$ 67,920</u>	<u>\$ 8,160</u>	<u>\$ 6,560</u>	<u>\$123,760</u>

<u>1958</u>					
Dillier	\$ 9,240	\$ 18,720	\$ 400	0	\$ 28,360
Kaelin	7,160	21,200	0	0	28,360
Curnow	28,360	0	0	0	28,360
Johnson	13,560	15,120	160	0	28,840
Halter	3,000	25,360	0	0	28,360
Totals	<u>\$61,320</u>	<u>\$ 80,400</u>	<u>\$ 560</u>	<u>0</u>	<u>\$142,280</u>

<u>1959</u>					
Dillier	\$ 6,240	\$ 18,720	0	0	\$ 24,960
Kaelin	4,160	30,300	0	0	34,460
Curnow	29,960	4,750	0	0	34,710
Johnson	10,400	24,310	0	0	34,710
Halter	0	34,960	0	0	34,960
Totals	<u>\$50,760</u>	<u>\$113,040</u>	<u>0</u>	<u>0</u>	<u>\$163,800</u>

The net income (or loss) of the Made Rite corporations for the years 1955 through 1959, as shown on the returns filed for those years, was as follows (II-R. 223, 235):

	<u>1955<sup>4/</sup></u>	<u>1956</u>	<u>1957</u>	<u>1958</u>	<u>1959</u>
usage	\$ 12,740.72	\$100,401.42	\$57,609.51	\$ 37,922.00	\$ 73,162.91
manufacturing	112,101.02	39,661.29	(57,757.27)	17,842.62	160,419.10
vestment	21,744.44	18,288.87	55,020.57	54,255.37	31,149.49
ansportation	<u>30,974.40</u>	<u>30,133.25</u>	<u>33,695.23</u>	<u>41,531.81</u>	<u>57,513.89</u>
Totals	\$177,560.58	\$188,484.83	\$88,568.04	\$151,551.80	\$322,245.39

<sup>4/</sup> Period July 18, 1955 through December 31, 1955.



During the period 1955 through 1959, the Made Rite corporations paid dividends as follows (II-R. 235):

	<u>Sausage</u>	<u>Manufacturing</u>	<u>Transportation</u>	<u>Investment</u>
1955	-o-	-o-	-o-	-o-
1956	-o-	\$11,000 [1]	-o-	-o-
1957	\$ 37,000	-o-	-o-	-o-
1958	25,000	-o-	-o-	-o-
1959	<u>57,078</u>	<u>-o-</u>	<u>-o-</u>	<u>-o-</u>
Totals	\$119,578	\$11,000	-o-	-o-

[1] This amount represents the payments made by Manufacturing in February 1956, prior to the issuance of the stock.

The Commissioner of Internal Revenue disallowed surtax exemptions to the four Made Rite corporations in his deficiency notices for the taxable years 1956 through 1959 on the ground that the corporations were created, availed of, and operated in order to avoid federal income taxes by securing the benefit of the surtax exemption which they would not otherwise enjoy. (I-R. 11, 13, 78, 80, 145; II-R. 235A.) In his opening statement, counsel for the Commissioner conceded that one surtax exemption should be allowed, either to one of the corporations or apportioned among the four corporations. (II-R. 247; IIA-R. 11-12.)

The Tax Court found that the principal purpose for the organization of the four Made Rite corporations, rather than a single corporation, and the acquisition of all of the stock of the corporations by the partners was to avoid federal income tax by securing the benefit of three additional surtax exemptions which would not otherwise have been available.

(II-R. 237-238.) The court allocated one surtax exemption to Sausage for the taxable years 1956 and 1957. (II-R. 254-255.) 5/

## II

### Reasonable compensation

On its income tax returns for the taxable years 1956 and 1957, Investment claimed deductions for compensation paid as follows (II-R. 235A):

	<u>1956</u>	<u>1957</u>
Thores Johnson	\$25,800.00	\$1,760.00
Joseph Dillier	--	4,800.00
Geneva Hayhurst	5,238.00	--
Chester Brewster	2,916.80	--
M. Schoenbacker	<u>55.00</u>	<u>--</u>
Totals	\$34,009.80	\$6,560.00

Johnson had been in charge of the office and clerical functions, credit collections, advertising and bookkeeping, purchasing of packaging supplies, and labor relations of the partnership. In 1955, he assumed more of the general managerial duties when Dillier took a less active and more advisory role in the business of the partnership. (II-R. 215.) When the business conducted by the partnership was incorporated, the same division of duties among the former partners was maintained. (II-R. 231.)

Johnson devoted some time during 1956 to the affairs of a corporation named Zephyr Heights Subdivision, Inc., at Lake Tahoe, for which he received a salary of \$4,800. In September 1956, he had one or more

---

5/ The Tax Court also held that the business activities of the partnership had not been taken over by the Made Rite corporations during 1955. Consequently, the gross income and deductions reported by the corporations for that year were reportable by the partnership and the distributable shares of the partners were includible in their individual returns for 1955. (II-R. 235-236, 237.) The partners have not sought review of this holding.

telephone conversations with a real estate brokerage firm in Los Angeles, California, and received a letter from that firm naming a prospective purchaser of the Made Rite plant, but no sale was made to the person named. Prior to or on January 29, 1957, Johnson met with one or more representatives of a company named Arden Milk Company. A letter dated January 29, 1957, written by a representative of Arden stated that (II-R. 235A-236):

Arden is interested in working out a merger [sic] with the Maid-Rite [sic] Co. and are ready to do so as soon as we get the papers outlining the best exchange of Arden's stock for that of Maid-Rite [sic] plus the lease-back idea, talked about in your meeting.

However, no transaction was consummated with Arden Milk Company. (II-R. 236.)

Dillier had been the general manager of the partnership, but beginning in 1955 he took a less active role in the business and his duties became advisory in nature. (II-R. 215.) This division of duties continued after the business was incorporated. (II-R. 231.)

Geneva Hayhurst had been employed by the partnership in 1941 as a bookkeeper. During 1956, she was the office manager for the four corporations but received compensation only from Investment. Her duties included supervision of the office services for all four corporations and keeping the books for Sausage and Manufacturing. The bulk of her work was concerned with the business of Sausage and only a small portion of her time was devoted to the affairs of Investment. The books of Investment and Transportation were kept by another bookkeeper in the office. Investment paid no other office salaries during the years 1956 through 1959 and it did not claim a deduction for any office expenses on its returns for those

years. During 1957, 1958, and 1959, Miss Hayhurst received no compensation from Investment. The record does not indicate which of the other Made Rite corporations paid her salary for those years. (II-R. 236.)

Chester Brewster had been the night watchman for the partnership and he continued to perform the same function after the four corporations took over the business. His duties were to guard the main plant building, the title to which was transferred to Investment in 1956, as well as the property belonging to the other Made Rite corporations located on the plant premises, including trucks, title to which was in Transportation, and machinery and inventory, which were listed as belonging to Manufacturing. (II-R. 236-237.)

M. Schoenbacker acted as night watchman for one week during 1956 while Brewster was on vacation. (II-R. 237.)

The amounts paid by Investment during 1956 to Brewster and to Schoenbacker were the only amounts paid by any of the Made Rite corporations for the services of night watchmen during that year. During 1957, 1958, and 1959, the night watchmen employed in the Made Rite businesses received their entire compensation from Manufacturing. (II-R. 237.)

The Commissioner disallowed as unreasonable \$32,009.80 of the total \$34,009.80 claimed as a deduction by Investment for salaries in 1956. He also disallowed \$4,300 of the \$6,560 claimed in 1957. (I-R. 11, 13; II-R. 237.)

Transportation claimed as deductions for compensation paid to Dillier in 1956 and 1957 the amounts of \$23,800 and \$6,400, respectively. (II-R. 233-234.) The Commissioner determined that only \$500 in each of these years represented a reasonable allowance for services rendered. (I-R. 78, 80; II-R. 237.)



The Tax Court found that the following amounts represented reasonable compensation for services rendered to Investment and Transportation (II-R-238):

	<u>Year</u>	<u>Employee</u>	<u>Amount</u>
Investment:	1956	Johnson	\$1,760
		Hayhurst	500
		Brewster	1,200
		Schoenbacker	25
	1957	Johnson	1,760
		Dillier	500
Transportation:	1956	Dillier	500
	1957	Dillier	500

#### SUMMARY OF ARGUMENT

This case presents two questions in the context of a multiple corporation scheme. A partnership composed of five men operated a business which manufactured and sold sausage products, hams, and bacon. It owned its own plant and sales trucks. In 1955, the partners decided to incorporate the business and they utilized four corporations. One corporation took over the manufacturing operation and another handled the sales. The real estate was transferred to a third corporation and the trucks to a fourth corporation. The truck, real estate, and manufacturing corporations are involved in this review.

1. The corporate income tax is composed of a normal tax applicable to all taxable income, and a surtax applicable to taxable income in excess of \$25,000. By utilizing four corporations instead of one, the partners, equal shareholders of the stock of all four corporations, obtained the benefit of three additional surtax exemptions. The Tax Court found that the principal purpose for the organization of four corporations, rather than one, was to avoid tax by obtaining the additional surtax exemptions.

On review, we assert that this finding is supported by substantial evidence and is not clearly erroneous. Thores Johnson, the partner who researched the problem of incorporation, understood at the time the corporations were organized that three additional surtax exemptions would be available under the multiple corporation scheme. After incorporation, the four corporations operated the business as a single integrated operation. Sausage, the sales corporation, sold, with few exceptions, only the products manufactured by Manufacturing. Transportation rented all of its trucks to Sausage; Investment, the real estate corporation, rented all of the real estate to Sausage, Manufacturing, and Transportation, except for a parking lot and a few residential units. The corporations all used the same office, and generally the same employees kept their books. The same trade names and signs formerly used by the partnership were used by the corporations. The establishment of the four corporations was not publicized.

However, Johnson testified that obtaining additional surtax exemptions was not the decisive reason for adopting the multiple corporation scheme. He listed a number of factors which he claimed motivated the formation of the four corporations. These factors indicate, at most, only a need for one corporation, not four. The evidence that the partners were aware of the tax advantages of forming multiple corporations and the evidence that the stockholders operated the corporations as a single integrated operation plainly indicate that only one corporation was necessary and that the additional three corporations were formed to avoid tax by obtaining additional surtax exemptions.



2. Two of the corporations, Investment and Transportation, made payments to certain officers and employees during the years 1956 and 1957 which they claimed as deductions for compensation. The Commissioner disallowed them and the Tax Court determined the amount of reasonable compensation paid to these officers and employees and allowed deductions to that extent. The officers and employees involved performed services for more than one of the corporations, but only one paid them. They spent only a part of their working time on the affairs of the corporation who paid them, yet that corporation claimed as deductions the entire amounts paid to them.

The position of these corporations on review seems to be that the deductions are allowable in full since the officers and employees in question performed services for the collective Made Rite enterprise. However, the deduction for business expenses is limited to the ordinary and necessary expenses of the taxpayer. Deductions are personal to the corporate taxpayer and are not transferable or usable by another corporation. The taxpayers contend, and the Tax Court held, that each of the Made Rite corporations has a separate and independent existence. It cannot be said that it was an ordinary and necessary expense of the respective taxpayers to compensate officers and employees for services which they rendered to one or more of the other Made Rite corporations.

## ARGUMENT

### I

THE TAX COURT CORRECTLY FOUND THAT THE PRINCIPAL PURPOSE FOR THE ORGANIZATION OF THE FOUR MADE RITE CORPORATIONS, RATHER THAN ONE CORPORATION, WAS TO AVOID TAX BY SECURING THE BENEFIT OF THREE ADDITIONAL CORPORATE SURTAX EXEMPTIONS

A. The question of principal purpose is a question of fact; its resolution must be affirmed on review if it is supported by substantial evidence and is not clearly erroneous

The federal corporate income tax consists of two parts; a normal tax is imposed on all taxable income and a surtax is imposed on all taxable income in excess of \$25,000. The rates of both the normal tax and the surtax have varied. During the taxable period here in question, 1956 through 1959, the normal tax was 30 percent of taxable income and the surtax was 22 percent of taxable income above \$25,000. Section 11, Internal Revenue Code of 1954, Appendix, infra. Since the first \$25,000 of corporate taxable income is exempt from the surtax, it is obviously beneficial to arrange to divide taxable income among several corporations and thereby obtain several surtax exemptions. 6/

Section 269 of the Internal Revenue Code of 1954, Appendix, infra, provides the Commissioner with a means of preventing tax avoidance in such situations. That provision states that if any person acquires control of a corporation, "and the principal purpose" for the acquisition

---

5/ The Congressional intent in providing surtax exemptions to corporations was to facilitate the creation and expansion of small business. H. Rep. No. 586, 82d Cong., 1st Sess., p. 23 (1951-2 Cum. Bull. 357, 374); S. Rep. No. 781, 82d Cong., 1st Sess., p. 15 (1951-2 Cum. Bull. 458, 469).

is "evasion or avoidance of Federal income tax by securing the benefit of a deduction, credit, or other allowance which such person would not otherwise enjoy," that "deduction, credit, or other allowance shall not be allowed." Section 269 applies to disallow multiple corporate surtax exemptions. Kessmar Construction Co. v. Commissioner, 336 F. 2d 865 (C.A. 9th); Bonneville Locks Towing Co. v. United States, 343 F. 2d 790 (C.A. 9th). See also James Realty Co. v. United States, 280 F. 2d 394 (C.A. 8th). The section applies to disallow items to the acquired corporations as well as to the acquiring person. Commissioner v. British Motor Car Distributors, Ltd., 278 F. 2d 392 (C.A. 9th); Urban Redevelopment Corp. v. Commissioner, 294 F. 2d 328 (C.A. 4th); Treasury Regulations on Income Tax (1954 Code), Section 1.269-3(a), Appendix, infra.

The determination whether the principal purpose for the acquisition of corporate stock is the avoidance of tax is a question of fact to be resolved by the trier of fact. Kessmar Construction Co. v. Commissioner, supra; Bonneville Locks Towing Co. v. United States, supra. To constitute the principal purpose, the purpose to avoid tax must exceed in importance any other purpose. Hawaiian Trust Co. v. United States, 291 F. 2d 761, 765-766 (C.A. 9th). See also, Treasury Regulations on Income Tax (1954 Code), Section 1.269-3(b)(2), Appendix, infra. Thus, the tax avoidance purpose need not constitute the sole purpose, nor must it exceed in importance the sum of all other purposes. It is sufficient to invoke Section 269 if the tax avoidance purpose is more significant than any other purpose.

We agree with the taxpayers (Br. 35-36) that where the trier of fact -- in this case, the Tax Court -- has decided the factual question whether there was present the requisite principal purpose to avoid tax, the only inquiry open to the reviewing court is whether the finding of fact is supported by substantial evidence and is not clearly erroneous. United States v. Gypsum Co., 333 U.S. 364, 395; Kessmar Construction Co. v. Commissioner, supra. The rule applies as well to factual inferences drawn from undisputed basic facts. Commissioner v. Duberstein, 363 U.S. 278.

B. The evidence fully supports the finding of the Tax Court

The partnership composed of Dillier, Curnow, Halter, Johnson, and Kaelin had carried on an integrated business of manufacturing and selling sausage products, and the four Made Rite corporations carried on this same business as an integrated operation. Mr. Johnson, who was the taxpayers' principal witness at the trial, testified that he was aware of the surtax advantages of multiple corporations at the time the corporations were organized, but stated that it was not a decisive reason. Rather, he recited a number of alleged reasons which he claimed had motivated the partners to adopt the multiple corporation scheme. Although some of these alleged reasons were somewhat unclear, the principal ones, as noted by the Tax Court (II-R. 249), were: (1) Problems potentially arising from the death of a stockholder would be reduced; (2) labor problems would be minimized; (3) more accurate accounting figures for each function of the business would be obtained; (4) limited liability would be



obtained for each corporation; (5) the adoption of profit-sharing or incentive plans would be facilitated; (6) unequal cash withdrawals by the partners would be eliminated; and (7) the discounting of secured notes issued to the stockholders could provide funds to pay off certain personal obligations of the stockholders. 7/

The Tax Court analyzed in detail each of the seven alleged reasons listed by Johnson and found them lacking in substance. (II-R. 249-253.) The court concluded its lengthy analysis with the statement (II-R. 253):

We are convinced, from our study of the record, that the alleged business objectives did not in fact motivate the organization of the multiple corporations. The one purpose of apparent substance was the obtaining of the additional surtax exemptions of which Johnson had cognizance.

Consequently, the Tax Court found that the principal purpose for the organization of the four Made Rite corporations, instead of one corporation, was to avoid federal income tax by obtaining the benefit of three additional surtax exemptions. (II-R. 237-238.)

The taxpayers contend here (Br. 38, 42-48), as they did in the court below (II-R. 247, 249), that each was organized for a valid business purpose and that each was a viable business entity which was actually engaged

---

7/ For convenience, we list these alleged reasons in the order in which the Tax Court listed and discussed them. (II-R. 249-253.) In our subsequent consideration of them, we will discuss them in the order in which Johnson listed them, but numbering them (e.g., Item 1, Item 2, etc.) as the Tax Court did.

in a substantive business activity. 8/ The record, however, plainly establishes that the principal purpose for the organization of the four Made Rite corporations, rather than one corporation, was to avoid tax by securing the benefit of three additional corporate surtax exemptions.

1. The operation of the corporations

The manner in which the partner-stockholders operated the Made Rite business after incorporation belies the need for four corporations. Prior to incorporation, the partnership carried on the meat packing business as a single integrated operation. The partnership bought raw meat supplies and manufactured or processed them into sausage products, ham, and bacon in its own manufacturing plant. It sold its finished products to retail outlets through driver-salesmen operating trucks owned by the partnership in a sales territory which covered the northern two-thirds of California. (II-R. 214, 216.)

When the corporations commenced business, they operated a single, integrated business enterprise. It was the same business which had been previously operated as a single enterprise by the partnership. The five shareholders carried out the same responsibilities which they had previously

---

9/ It should be noted that the Tax Court made no finding that any of the taxpayers were not viable corporations. If such were the case, then the income reported by the four corporations would be taxable to the viable one. See Shaw Construction Co. v. Commissioner, 323 F. 2d 316 (C.A. 9th); Edon Homes, Inc. v. Commissioner, 33 T.C. 582. Here, the Tax Court found that more than one corporation had been formed to avoid tax and invoked Section 269 to deny to the other three corporations the surtax exemptions. Consequently, the argument and authorities advanced by the taxpayers (Br. 40-44) for the proposition that the taxpayers are viable taxable entities are irrelevant.



had as partners. (IIA-R. 181-186, 261-263.) There was no change in the products handled, the sales territory covered, or in the personnel used in the business. The overall nature of the business did not change; the partner-stockholders did not want it to change. (IIA-R. 195-196.)

The meat products manufactured or processed by Manufacturing were sold only through Sausage and all sales receipts were deposited in the bank accounts of Sausage. (IIA-R. 194, 196.) Although Sausage was purportedly an independent corporation selling meat products, it sold only the products of Manufacturing, with minor exceptions, and carried no inventory on its books. (II-R. 231; IIA-R. 194.) The entire inventory of the business was recorded on the books of Manufacturing, and "sales" from Manufacturing to Sausage were determined by calculations made after Sausage had sold the products to customers. These calculations were either made on the basis of a certain price per pound or ton of the products sold or on the basis of certain percentages of the dollar amount of the gross sales of Sausage. The price or percentage was set by the stockholders. (II-R. 231; IIA-R. 307-308.)

All of the rental income of Investment was derived from intercompany payments from the other three corporations, except for small amount received from the rental of a parking lot and a few residential units to unrelated parties. (II-R. 231-232.) All of the rental income of Transportation represented intercompany payments from Sausage; Transportation rented none of its vehicles to outsiders. (IIA-R. 194.)

- 21 -

The Made Rite corporations used the same office which the partnership had used. The records for the four corporations were all kept at that office and generally by the same employees. (II-R. 232.) The signs on the main plant and the office building were limited to "Camellia Brand" and "Made Rite Sausage". (IIA-R. 366-367.) The only listing for the business in the telephone directories was made in the name of Sausage. (Stip. par. 14, I-R. 199.) During 1955 and for an undisclosed period thereafter, stationery bearing the name Made Rite Sausage Company was used to transact business on behalf of all four Made Rite corporations. (II-R. 222.) No particular effort was made to tell customers or suppliers that four corporations were being used. (IIA-R. 203-204.)

In addition to the foregoing evidence that the stockholders operated the business in a manner requiring only one corporation, they also executed "Stock Purchase Agreements" which were designed to keep the business of the four corporations integrated by keeping the ownership of the stock in the stockholders and their children. Each agreement required a stockholder, before disposing of any of his stock in the corporation during his lifetime, to offer to sell it first to the corporation and then to the remaining stockholders. This requirement did not apply to sales or gifts of stock to children of the stockholders, but such dispositions could be effected only if the stockholders sold or gave to the child in question an equal percentage of his stock in all four Made Rite corporations. Moreover, the stock could only be disposed of by will to, or placed in an inter vivos trust for the benefit of, certain family members of the stockholder. Otherwise upon the death of a

stockholder, the corporation had the right to purchase the stock owned by the decedent and the surviving stockholders were required to purchase equally among themselves any stock not bought by the corporation. (II-R. 226-227.)

Each stock purchase agreement further provided that it was mutual with and reciprocally dependent upon the corresponding agreements executed between the five stockholders and each of the other three Made Rite corporations and that "an election, an offer to sell, or any notice given in pursuance of those agreements shall also be considered and construed as exercising the same act under this agreement." (II-R. 227.)

Finally, the business had an average net income in excess of \$200,000 while operated by the partnership. Its earnings were as follows (II-R. 216):

<u>Year</u>	<u>Partnership Net Income</u>
1948	\$244,248.69
1949	221,584.00
1950	191,904.00
1951	226,049.46
1952	275,341.90
1953	260,091.05
1954	231,453.96

As can be seen, there existed the likelihood that the income of a corporation or corporations which might be formed to operate the business might exceed a single surtax exemption of \$25,000.

The income of the four corporations consisted almost entirely of intercompany payments, whose amounts were controllable by the stockholder and their net income record indicates that they receive for the most part

full benefit of the surtax exemptions. The net income (or loss) of the corporations was as follows (II-R. 235):

	<u>1956</u>	<u>1957</u>	<u>1958</u>	<u>1959</u>
Sausage	\$100,401.42	\$57,609.51	\$ 37,922.00	\$ 73,162.91
Manufacturing	39,661.29	(57,757.27)	17,842.62	160,419.10
Investment	18,288.87	55,020.57	54,255.37	31,149.49
Transportation	<u>30,133.25</u>	<u>33,695.23</u>	<u>41,531.81</u>	<u>57,513.89</u>
Totals	\$188,484.83	\$88,568.04	\$151,551.80	\$322,245.39

## 2. The testimony of Thores Johnson

Thores Johnson, the only partner who testified, stated that at the time the four Made Rite corporations were formed, he understood that the business would get additional surtax exemptions if four corporations were formed rather than one. However, he also stated that extra surtax exemptions were not a decisive purpose in the adoption of the multiple corporation scheme. (IIA-R. 201-202.) He testified that he had asked William Himmelman, Jr., the partnership's outside accountant (IIA-R. 269), about the extra exemptions (IIA-R. 243); Himmelman denied telling Johnson that he could get additional exemptions (IIA-R. 321-322). Johnson also recited a number of alleged business reasons which he claimed motivated the organization of multiple corporations. (IIA-R. 29-38.)

The taxpayers contend (Br. 38, 44) that the Tax Court incorrectly interpreted Johnson's testimony in stating that there were seven principal reasons for the adoption of the four corporations (II-R. 249) and assert that there was in fact only one substantial business purpose, i.e., to provide for financial flexibility in the event of the death or retirement of a partner. This allegation is a curious one since it would seem



that the Tax Court erred, if it be that, in favor of the taxpayers. The court exhaustively analyzed a number of alleged reasons, including the ones underlying the purpose which the taxpayers now say was the real one providing for problems potentially arising from the death of a shareholder (Item 1) and obtaining funds by discounting secured notes issued by the corporations (Item 7) -- and ones which the taxpayers presently label as "merely incidental" (Br. 44). The taxpayers also suggest that the Tax Court, in considering the potential problems arising upon the death of a stockholder, entirely ignored the problem of a partner's retiring. (Br. 37-38.) However, the court did consider the basic issue when it considered the problem of providing funds to the stockholders for the satisfaction of their personal obligations by the discounting of secured notes of the corporations (Item 7) and the possible sale of the real estate and trucks to provide for the survivors upon the death of a partner (Item 1). Moreover, Johnson placed no emphasis in his testimony on retirement and its possible problems to the business and the partners (IIA-R. 29, 237-238), but discussed only the ramifications of a partner's death (IIA-R. 29-30).

In any event, an examination of the testimony given by Johnson indicates that he listed a number of alleged business reasons for the organization of the four corporations (IIA-R. 29-47), and that all of them were on his mind in the spring of 1955 (IIA-R. 47), when the decision was made to organize the Made Rite corporations (IIA-R. 48). He testified that the partners realized in 1954 that there were difficulties with the partnership form of organization which they were using. They were having trouble paying out of the earnings of the business the

otes which they owed to Dillier for the purchase of their interests in the partnership and they had had problems with the survivors of partners when a partner died. (IIA-R. 23.) He testified that he had had an insurance man investigate his personal estate planning problems with the partnership that year. (IIA-R. 25.) Johnson stated that the partners discussed the problem among themselves but failed to reach a solution. He said that he then searched for a solution: he talked to other businessmen, both those with general business experience and those in the industry; he discussed the problem with the partnership's banker and accountant; and he read material regarding it. (IIA-R. 24-25.) He stated that he had come to the tentative conclusion in 1954 that the best solution was to incorporate the business, utilizing four corporations. (IIA-R. 28-29.) In the spring of 1955, he discussed the plan with Mallard L. Madland, an officer in the bank to which the partnership was obligated (IIA-R. 264-265), who assured him that it was an excellent plan (IIA-R. 28-29, 264-265).

(a) Death of a partner-stockholder (Item 1)

At this point, counsel for the taxpayers asked Johnson (IIA-R. 29) "Will you give us some of these reasons that led you to the conclusion that the four corporations?" Johnson replied (IIA-R. 29) "Well, one thing was the advancing age of the partners, with death and retirement as factors." He then discussed the potential problems resulting from the death of a partner. Under the multiple corporation scheme, it was thought that the survivors might be persuaded to retain the stock of the corporations holding the real estate and trucks since they would yield a fixed income. In that circumstance, the remaining stockholders would have to raise cash



only to acquire the decedent's stock in the sales and manufacturing corporations. (IIA-R. 29-30.)

As the Tax Court pointed out (II-R. 249-250), this is no explanation for the use of more than one corporation. The purported intention to hold the real estate and trucks for the purpose of providing the survivor with a fixed income is inconsistent with the sale and leaseback of the trucks in 1962 (IIA-R. 30-31) and the efforts to do the same thing with the real estate (IIA-R. 26-28, 189-190). <sup>2/</sup> Moreover, the statement that the stock of the real estate and truck corporations would be attractive to the survivors because those corporations would have a "fixed income" (IIA-R. 30) is curious since the trucks provided no income except through their use in the meat packing business (IIA-R. 194), which Johnson at one point termed "speculative" (IIA-R. 39), and the real estate did not provide a significant amount of outside income (IIA-R. 195). Neither Investment nor Transportation paid dividends during the taxable period here in question. (II-R. 235.)

If the survivors did not desire to retain their stock in these two corporations, Johnson testified that their assets could be sold to raise the money necessary to pay the survivors. (IIA-R. 30.) However, he did not explain why a single corporation could not just as readily sell the real estate or trucks to raise the needed cash as multiple corporations.

---

<sup>2/</sup> The taxpayers make several references (Br. 38-39, 46, 48) to an alleged sale of the real estate in 1964. There is no evidence in the record of such a sale. Similarly, the taxpayers give no record reference for several statements regarding the alleged value of the assets of the taxpayers. (Br. 38, 42-43.)

brief (p. 39), the taxpayers suggest that a single corporation would have been able to take advantage of the tax-free liquidation provisions of Section 337 of the Internal Revenue Code of 1954, Appendix, Fra, while a separate real estate or truck corporation could. Section 337 allows a corporation, upon the adoption of a plan of complete liquidation, to sell its assets and liquidate without recognizing gain on the sale of its assets. The stockholders, of course, recognize gain since the liquidation is treated as full payment in exchange of their stock. Section 331(a), Internal Revenue Code of 1954 (26 U.S.C. 1958 ed., e. 331). Even if the taxpayers read Section 337 correctly, <sup>10/</sup> their attention is of no weight here since there is no indication in the record that any of the partners were motivated to utilize multiple corporations for this reason. Moreover, if the partners actually intended to sell real estate or the trucks, they could have avoided the considerable expense of organizing and maintaining two corporate organizations and any corporate tax on the sale of the assets by retaining those assets for sale by the partnership. In any event, the existence of Section 337 has no effect on Manufacturing, since there is no suggestion in the record that the partners considered the possible sale of the packing plant and equipment as a reason for organizing it.

(b) Security

Counsel for the taxpayers next asked Johnson (IIA-R. 32) "Did you have any other reasons that led you to this conclusion of four corporations that you talked over with your banker in the early part of 1955?"

---

2 There are certain limitations on the application of Section 337.

Johnson replied (IIA-R. 32) "We had the problem of security," and he went on to say that the partners, except for Dillier, had no assets apart from the business and that the industry was undergoing considerable change due to automation which required additional capital (IIA-R. 32-33). This apparently referred to the liability problem (Item 4) about which more will be said (pp. 37-38, infra).

(c) Accounting problem (Item 3)

Johnson was then asked (IIA-R. 33) "Were there other reasons that motivated you to form four corporations?" He replied (IIA-R. 33) "Yes, the accounting problem." He stated that under the partnership organization, costs were allocated among the various operations of the business, but that a partner heading one of the operations which produced a poor record would be inclined to say that it was the result of bookkeeping entries and did not reflect the true results of his department. He said that multiple corporations aided this problem because they were separate entities with separate bookkeeping. The charges were direct expenses of the corporations and there were not arbitrary charges between departments. (IIA-R. 33-34.)

However, as the Tax Court noted (II-R. 251), proper allocation of income and expenses could have been attained by a divisional accounting system. Moreover, it does not appear that the allocation between the corporations was made with any attempt at precision. For one thing, rental payments for the five executive automobiles were all accrued against Sausage (Supp. Stip. par. 91, I-R. 206), although some of the five stockholders were purportedly rendering services primarily to other corporations (II-R. 225, 233-234).

Moreover, under the multiple corporation scheme adopted, accounts would still involve considerable unreality since the stockholders fixed rent which Investment charged to other corporations for the use of real estate and the rent which Transportation charged Sausage for the use of the trucks. (IIA-R. 195-196.) The sales of Manufacturing were based on the sales of Sausage. (IIA-R. 307-308.) If the sales of Sausage, for example, were poor, the stockholder-officer primarily concerned with its operation could well shrug it off with the comment that a large amount had been paid to Manufacturing for making or processing the products, just as was done under the partnership organization. (IIA-R. 33.)

(d) Discounting notes (Item 7)

Counsel for the taxpayer next asked Johnson (IIA-R. 34) "\* \* \* any of the partners or prior partners have any marital problems?" Johnson stated that one of the partners had had a financial problem in obtaining a settlement when he divorced his wife. (IIA-R. 34-36.) He went on to say that their banker had indicated that the bank would advance funds on the corporate notes which were secured by the real estate and that such funds could be used by the partners to discharge their obligations to Dillier and by the one partner to satisfy his marital obligations. (IIA-R. 36-37.) On brief, the taxpayers state that this reason is part of the major business reason which motivated the formation of multiple corporations, i.e., financial flexibility. (Pp. 38, 44.)



However, the record contains no indication that the stockholders ever discounted the notes secured by the real estate (II-R. 228) which they received from Investment. Moreover, as the Tax Court pointed out (II-R. 252), the alleged reason provides no explanation why it was necessary to place the real estate in a separate corporation. If the partners had utilized a single corporation, presumably they would have conveyed the real estate to it in return for stock and for notes secured by the real estate, and they could then have discounted such notes with a bank to obtain the funds necessary to satisfy their personal obligations.

(e) Unequal cash withdrawals (Item 6)

Counsel for the taxpayer then asked (IIA-R. 37) "Had there ever been any problem of unequal drawings of partners?" Johnson replied that there had been continual conflict among the partners since they drew on partnership funds to pay their taxes and some of them owed different amounts of taxes. He said that the use of multiple corporations left each partner's tax problem directly to him; and dividends or other money distributed by the corporations would be in proportion to his interest and not in proportion to his taxes. (IIA-R. 38.) Again one wonders, as the Tax Court did (II-R. 252), why the same result could not have been achieved by a single corporation. The stock and notes of the four corporations were issued to the partners in equal amounts (II-R. 228); they consequently received equal dividend payments just as though they owned equal shares in a single corporation. On brief, the taxpayers imply that the unequal cash withdrawal problem was solved by putting the partners on fixed salaries. (P. 48.) Nevertheless, the question still goes unanswered why this result would not have been achieved by the use of one corporation.

(f) Limited liability (Item 4)

Johnson also testified that the partnership was meeting increasingly severe competition and that several firms in the industry had gone out of business. (IIA-R. 38-40.) He stated that multiple corporations would limit the liability of each corporation to the assets employed and, in the event that competition got so severe that the manufacturing plant could not be operated at a profit, they could close it up and purchase supplies for the sales corporation from other manufacturers and processors. (IIA-R. 39-41.)

Nevertheless, as the Tax Court noted (II-R. 251), when Manufacturing bought sizable lines of credit from a bank in 1957 and 1958, the other five Made Rite corporations guaranteed repayment of the funds to be advanced by the bank and the five stockholders subordinated the notes they personally held against the corporations to the obligations to the bank. (Supp. Stip. pars. 53-54, I-R. 202-203; IIA-R. 196-197.) Thus, the end result was the same as if a single corporation had been used.

With respect to the comment that the partners had limited the liability of the business to the general public (Br. 47), it should be noted that the partners did not represent themselves to their customers as four separate corporations and they made no formal announcement to suppliers that they were now dealing with Manufacturing (IIA-R. 203-204). Johnson testified that he had no way to be certain that suppliers knew of the change except that (IIA-R. 204) "when people would call whom we were dealing with we would assure them that the same people were responsible so that they would continue to supply us with meat, but some of them were aware that there



were other corporations." (Emphasis added.) He testified that some were aware that there were other corporations since there was information on file with the Credit Managers Association and a notice had been published in the newspapers. (IIA-R. 204.) However, there were no signs on the plant indicating that Manufacturing was operating the plant; no signs on the garage indicating that Transportation was using the garage. (IIA-R. 366.)

(g) Labor problem (Item 2)

Counsel for the taxpayer next asked (IIA-R. 41) "Did you feel the four corporations would have any effect on labor prior to '55?" The substance of Johnson's answer was that it was thought that if the employees of either the manufacturing corporation or the sales corporation went on strike, the other corporation could continue to operate, since its employees would be members of different unions. (IIA-R. 41-42.) However, Johnson testified further that the Made Rite business had never had a strike of any consequence; in the last thirty years, they had had only a few days lost because of strikes. (IIA-R. 241, 242.) He also stated (IIA-R. 241-242) that when there had been a strike by the members of the teamsters union (who worked for Sausage (IIA-R. 41)), their picket line had been honored by the members of the butchers' union (who worked for Manufacturing (IIA-R. 43)). Johnson also testified that the employee of the partnership belonging to the packers' union became employees of Manufacturing, but that neither the packers' union nor the association which had bargained with that union on behalf of the partnership were ever advised of the change of employer. (IIA-R. 187-188.)

This testimony was duly noted by the Tax Court. (II-R. 250.)

(h) Profit-sharing plans (Item 5)

Finally, counsel for the taxpayers asked whether Johnson had ever discussed pension or profit-sharing plans. (IIA-R. 46.) Johnson said the partners had hoped that with the sales and manufacturing functions in separate organizations, they could set up profit-sharing incentive plans which would give junior executives incentive and would allow them to share in their results. (IIA-R. 46.) The Tax Court noted that this argument was without foundation in the record. (II-R. 251-252.) There is no evidence that the corporations ever adopted any such plan or seriously considered doing so. (II-R. 252.) Again, Johnson offered no explanation why multiple corporations were necessary to achieve this purpose. Finally, the taxpayers assert that their action in voluntarily giving up several surtax exemptions is inconsistent with the finding that their principal purpose in organizing the corporations was to avoid tax by securing additional surtax exemptions. (Br. 48.) They point to the fact that Sausage elected to report its income for 1958 and thereafter was a small business corporation under Sections 1371-1377 of the Internal Revenue Code of 1954 (26 U.S.C. 1958 ed., Secs. 1371-1377), which is only referred to as Subchapter S. (II-R. 214, 253.) This provision provides, in general, for taxing the income of an electing corporation directly to its stockholders. Since there is no tax on the corporation, there is no surtax exemption.

However, the election made by Sausage to report income under Subchapter S is not inconsistent with the finding of the Tax Court. In the first place, Subchapter S was not added to the Code until 1958 (Technical Amendments Act of 1958, P.L. 85-866, 72 Stat. 1606, Sec. 64(a)), several years after the partners made the decision to organize four corporations in the spring of 1955. (IIA-R. 48.) They claimed the benefit of four surtax exemptions for part of 1955 and for 1956 and 1957. Moreover, considerable benefit was obtained from the surtax exemptions of the taxpayers after Sausage elected to report under Subchapter S. In 1958 and 1959, Sausage had a net income of \$37,922 and \$73,162.91, respectively, and it paid dividends in those years which amounted to \$25,000 and \$57,071. The taxpayers paid no dividends during those years. (II-R. 235.) Thus, by adopting Subchapter S, it was possible to make all dividend payments from Sausage without reduction by corporate taxes, while retaining the benefit of the surtax exemptions of the other three corporations.

The references (Br. 48) made to the loss of surtax exemptions upon the dissolution of Investment and Transportation are also unconvincing. Transportation was liquidated in 1962 (II-R. 237); on brief, the taxpayer state that Investment was dissolved in 1964 (Br. 48). These events took place a number of years after the corporations were formed; these corporations claimed the benefit of surtax exemptions throughout the period here in question.

In summary, there was evidence before the Tax Court that the partners understood that three additional surtax exemptions would be obtained

the organization of four corporations rather than one. While there is also testimony concerning a number of business reasons which were claimed to have motivated the organization of four corporations, the foregoing analysis indicates that they were lacking in substance. At most, they support the organization of one corporation. There was also evidence that the stockholders operated the Made Rite business after incorporation in a manner requiring only one corporation. In essence, the evidence, we submit, indicates reasons for forming one corporation, but little reason for organizing four -- except the awareness that three additional surtax exemptions would be available. In this light, the finding of the Tax Court -- which heard the testimony and assessed the credibility of the witnesses -- that the principal purpose for organizing the taxpayers was to obtain three additional surtax exemptions is clearly supported by substantial evidence and is plainly correct. Kessmar Construction Co. v. Commissioner, 336 F. 2d 865 (C.A. 9th); Bonneville Locks and Dam Co., v. United States, 343 F. 2d 790 (C.A. 9th).



## II

### THE TAX COURT CORRECTLY DETERMINED THE AMOUNTS OF DEDUCTIONS FOR COMPENSATION PAID TO CERTAIN OFFICERS AND EMPLOYEES OF INVESTMENT AND TRANSPORTATION

Under Section 162(a) of the Internal Revenue Code of 1954, Appendix, infra, a taxpayer is allowed as a deduction all the "ordinary and necessary expenses paid or accrued during the taxable year in carrying on any trade or business," including a reasonable allowance for salaries or other compensation for personal services actually rendered. Three factors must be present before a payment may be deducted as a salary expense under this provision: (1) the payment is in fact compensation; (2) the recipient has actually rendered personal services; and (3) the amount is reasonable when measured by the amount and quality of the services performed with respect to the business of the particular taxpayer. Doernbecher Mfg. Co. v. Commissioner, 95 F. 2d 296, 297 (C.A. 9th); 4 Mertens, Law of Federal Income Taxation, Section 25.61. The question of reasonableness is a question of fact. Hoffman Radio Corp. v. Commissioner, 177 F. 2d 264 (C.A. 9th); Doernbecher Mfg. Co. v. Commissioner, supra.

In the instant case, Investment and Transportation claimed as deductions on their returns for 1956 and 1957 amounts paid to Johnson and Dillier and to certain employees. (II-R. 235A.) The Commissioner disallowed a portion of these claimed deductions as unreasonable. (I-R. 11, 13, 78, 80.) The Tax Court made an exhaustive review of the evidence (II-R. 255-260) and determined the amounts which represented

reasonable compensation to these officers and employees for the services which they rendered to the payor in question (II-R. 238). One common thread runs throughout its discussion of the evidence; the officers and employees in question performed duties for several of the Made Rite corporations, they were paid by one corporation, yet that corporation was claiming the entire amounts paid as deductions for compensation for services rendered to it. (II-R. 255-260.)

Investment and Transportation present no discussion of their contention that the Tax Court erred in resolving the question for reasonable compensation. They merely quote from the opinion in Fine Realty, Inc. v. United States, 209 F. Supp. 286, 290 (Minn.), and submit that the compensation paid to the officers and employees in question was "fair and reasonable." (Br. 49-50.) Their position seems to be that it is irrelevant that Investment and Transportation paid salaries in excess of the value of the services rendered to them since these officers and employees performed some services for the collective Made Rite enterprise.

This argument ignores the statute. To be deductible under Section 162, the payment must be an "ordinary and necessary expense" of the taxpayer. Payments which Investment made for services rendered to the other Made Rite corporations are not an "ordinary and necessary expense" of its operations.

Deductions are a matter of legislative grace and a corporate taxpayer has the burden of clearly showing its right to the deduction. Interstate Transit Lines v. Commissioner, 319 U.S. 590, 593; ABC Brewing



Corp. v. Commissioner, 224 F. 2d 483, 490 (C.A. 9th). Deductions are also personal to the corporate taxpayer and "are not transferable to or usable by another." New Colonial Co. v. Helvering, 292 U.S. 435, 440; E. & J. Gallo Winery v. Commissioner, 227 F. 2d 699, 705 (C.A. 9th). See also, Interstate Transit Lines v. Commissioner, supra.

In this case, taxpayers contend that each of the four corporations was a separate viable entity. (Br. 40-44.) Indeed, the Commissioner and the Tax Court did not consider the Made Rite corporations to be shams but in fact confirmed their separate and independent existence by invoking Section 269 to deny the surtax exemptions. See footnote 8, supra.

The Tax Court analyzed in detail (II-R. 255-260) the evidence concerning the services (or lack of services) which the officers and employees in question rendered to Investment and Transportation -- Johnson (IIA-R. 162, 169-170, 179, 180, 184-185, 197-201, 247), Dillier (IIA-R. 174-176, 184, 185-186, 191-193, 365), Geneva Hayhurst (IIA-R. 162-163, 365, 369-370), Chester Brewster (IIA-R. 163, 166, 170, 179-180, 244-245), and M. Schoenbacker (IIA-R. 169, 170, 180) -- and determined the amounts of reasonable compensation paid to them (II-R. 235A-237, 238). On review, these findings of the Tax Court must be sustained if they are supported by substantial evidence and are not clearly erroneous. United States v. Gypsum Co., 333 U.S. 364, 395.

Investment and Transportation apparently concede that the findings of reasonable compensation paid to the officers and employees in question are correct since they present no argument to show in what respect these

amounts are clearly wrong. (Br. 49-50.) They had the burden of showing error on review; having failed to argue the point, they must be deemed to have waived it. Kimball Laundry Co. v. United States, 166 F. 2d 856, 59 (C.A. 9th). Consequently, we present no discussion of the evidence but stand on the findings and extensive analysis of the Tax Court.

#### CONCLUSION

For the foregoing reasons, the decisions of the Tax Court should be affirmed.

Respectfully submitted,

RICHARD M. ROBERTS,  
Acting Assistant Attorney General.

MEYER ROTHWACKS,  
RICHARD J. HEIMAN,  
J. EDWARD SHILLINGBURG,  
Attorneys,  
Department of Justice,  
Washington, D.C. 20530.

NOVEMBER, 1965.

#### CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

---

J. EDWARD SHILLINGBURG  
Attorney

Dated this \_\_\_\_\_ day of November, 1965.

- 40 -  
APPENDIX

Internal Revenue Code of 1954:

SEC. 11. TAX IMPOSED.

(a) Corporations in General.--A tax is hereby imposed for each taxable year on the taxable income of every corporation. The tax shall consist of a normal tax computed under subsection (b) and a surtax computed under subsection (c).

(b) Normal Tax.--

(1) [as amended by the Tax Rate Extension Act of 1958, P.L. 85-475, 72 Stat. 259, Sec. 2] Taxable years beginning before July 1, 1959.--In the case of a taxable year beginning before July 1, 1959, the normal tax is equal to 30 percent of the taxable income.

\* \* \*

(c) Surtax.--The surtax is equal to 22 percent of the amount by which the taxable income (~~computed~~ without regard to the deduction, if any, provided in section 242 for partially tax-exempt interest) exceeds \$25,000.

\* \* \*

(26 U.S.C. 1958 ed., Sec. 11.)

SEC. 162. TRADE OR BUSINESS EXPENSES.

(a) In General.--There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including--

(1) a reasonable allowance for salaries or other compensation for personal services actually rendered;

\* \* \*

(26 U.S.C. 1958 ed., Sec. 162.)

SEC. 269. ACQUISITIONS MADE TO EVADE OR AVOID INCOME TAX.

(a) In General.--If--

(1) any person or persons acquire, or acquired on or after October 8, 1940, directly or indirectly, control of a corporation, or

\*

\*

\*

and the principal purpose for which such acquisition was made is evasion or avoidance of Federal income tax by securing the benefit of a deduction, credit, or other allowance which such person or corporation would not otherwise enjoy, then such deduction, credit, or other allowance shall not be allowed. For purposes of paragraphs (1) and (2), control means the ownership of stock possessing at least 50 percent of the total combined voting power of all classes of stock entitled to vote or at least 50 percent of the total value of shares of all classes of stock of the corporation.

\*

\*

\*

(26 U.S.C. 1958 ed., Sec. 269.)

SEC. 337. GAIN OR LOSS ON SALES OR EXCHANGES IN CONNECTION WITH CERTAIN LIQUIDATIONS.

(a) General Rule.--If--

(1) a corporation adopts a plan of complete liquidation on or after June 22, 1954, and

(2) within the 12-month period beginning on the date of the adoption of such plan, all of the assets of the corporation are distributed in complete liquidation, less assets retained to meet claims,

then no gain or loss shall be recognized to such corporation from the sale or exchange by it of property within such 12-month period.

\*

\*

\*

(c) Limitations.--

(1) Collapsible corporations and liquidations to which section 333 applies.--This section shall not apply to any sale or exchange--

(A) made by a collapsible corporation (as defined in section 341(b)), or

\*

\*

\*

(26 U.S.C. 1958 ed. Sec. 337 )



SEC. 341. COLLAPSIBLE CORPORATIONS.

(a) Treatment of Gain to Shareholders.--Gain from--

(1) the sale or exchange of stock of a collapsible corporation,

(2) a distribution in partial or complete liquidation of a collapsible corporation, which distribution is treated under this part as in part or full payment in exchange for stock, and

(3) a distribution made by a collapsible corporation which, under section 301 (c) (3) (A), is treated, to the extent it exceeds the basis of the stock, in the same manner as a gain from the sale or exchange of property,

to the extent that it would be considered (but for the provisions of this section ) as gain from the sale or exchange of a capital asset held for more than 6 months shall, except as provided in subsection (d), be considered as gain from the sale or exchange of property which is not a capital asset.

(b) Definitions.--

(1) Collapsible corporation.--For purposes of this section, the term "collapsible corporation" means a corporation formed or availed of principally for the manufacture, construction, or production of property, for the purchase of property which (in the hands of the corporation) is property described in paragraph (3), or for the holding of stock in a corporation so formed or availed of, with a view to--

(A) the sale or exchange of stock by its shareholders (whether in liquidation or otherwise), or a distribution to its shareholders, before the realization by the corporation manufacturing, constructing, producing, or purchasing the property of a substantial part of the taxable income to be derived from such property, and

(B) the realization by such shareholders of gain attributable to such property.

(2) Production or purchase of property.--For purposes of paragraph (1), a corporation shall be deemed to have manufactured, constructed, produced, or purchased property, if--

\*

\*

\*

(B) it holds property having a basis determined, in whole or in part, by reference to the cost of such property in the hands of a person who manufactured, constructed, produced, or purchased the property, or

\* \* \*

(3) Section 341 assets.--For purposes of this section, the term "section 341 assets" means property held for a period of less than 3 years which is--

\* \* \*

(D) property described in section 1231 (b) (without regard to any holding period therein provided), except such property which is or has been used in connection with the manufacture, construction, production, or sale of property described in subparagraph (A) or (B).

In determining whether the 3-year holding period specified in this paragraph has been satisfied, section 1223 shall apply, but no such period shall be deemed to begin before the completion of the manufacture, construction, production, or purchase.

\* \* \*

(26 U.S.C. 1958 ed., Sec. 341.)

# SEC. 1231. PROPERTY USED IN THE TRADE OR BUSINESS AND INVOLUNTARY CONVERSIONS.

\* \* \*

(b) Definition of Property Used in the Trade or Business.--  
For purposes of this section--

(1) General rule.--The term "property used in the trade or business" means property used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 167, held for more than 6 months, and real property used in the trade or business, held for more than 6 months, which is not--

(A) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year,

(B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or



(C) a copyright, a literary, musical, or artistic composition, or similar property, held by a taxpayer described in paragraph (3) of section 1221.

\*

\*

\*

(26 U.S.C. 1958 ed., Sec. 1231.)

Treasury Regulations on Income Tax (1954 Code):

§ 1.269-3 Instances in which section 269(a) disallows a deduction, credit, or other allowance.

(a) Instances of disallowance. Section 269 specifies two instances in which a deduction, credit, or other allowance is to be disallowed. These instances, described in paragraphs (1) and (2) of section 269(a), are those in which--

(1) Any person or persons acquire, or acquired on or after October 8, 1940, directly or indirectly, control of a corporation, or

\*

\*

\*

In either instance the principal purpose for which the acquisition was made must have been the evasion or avoidance of Federal income tax by securing the benefit of a deduction, credit, or other allowance which such person or persons, or corporation, would not otherwise enjoy. If this requirement is satisfied, it is immaterial by what method or by what conjunction of events the benefit was sought. Thus, an acquiring person or corporation can secure the benefit of a deduction, credit, or other allowance within the meaning of Section 269 even though it is the acquired corporation that is entitled to such deduction, credit, or other allowance in the determination of its tax. If the purpose to evade or avoid Federal income tax exceeds in importance any other purpose, it is the principal purpose. This does not mean that only those acquisitions fall within the provisions of section 269 which would not have been made if the evasion or avoidance purpose was not present. The determination of the purpose for which an acquisition was made requires a scrutiny of the entire circumstances in which the transaction or course of conduct occurred in connection with the tax result claimed to arise therefrom. For the presumption of a principal purpose of tax evasion or avoidance see section 269(c) and § 1.269-5.

(b) Acquisition of control; transactions indicative of purpose to evade or avoid tax. If the requisite acquisition of control within the meaning of paragraph (1) of section 269(a) exists, the transactions set forth in the following subparagraphs are among those which, in the absence of additional evidence to the contrary, ordinarily are indicative that the principal purpose for acquiring control was evasion or avoidance of Federal income tax:

\*

\*

\*

(2) A person or persons organize two or more corporations instead of a single corporation in order to secure the benefit of multiple surtax exemptions (see section 11(c)) or multiple minimum accumulated earnings credits (see section 535(c)(2) and (3)).

\*

\*

\*

(26 C.F.R., § 1.269-3.)

§ 1.337-1 General.

\* \* \* Sales or exchanges made by a collapsible corporation (as defined in section 341(b)) are excluded from the operation of section 337 by section 337(c). Accordingly, section 337 does not apply to any sale or exchange of property whenever the distribution of such property in partial or complete liquidation to the shareholders in lieu of such sale or exchange would have resulted in the taxation of the gain from such distribution in the manner provided in section 341(a) as to any shareholder or would have resulted in the taxation of the gain in such manner, but for the application of section 341(d). \* \* \*

(26 C.F.R., § 1.337-1.)



IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

---

GEORGE L. BOCK, Appellant

v.

UNITED STATES OF AMERICA, Appellee

---

APPEAL FROM THE UNITED STATES DISTRICT COURT  
FOR THE EASTERN DISTRICT OF WASHINGTON,  
SOUTHERN DIVISION

---

BRIEF FOR THE UNITED STATES

---

EDWIN L. WEISL, JR.,  
Assistant Attorney General.

FRANK R. FREEMAN,  
United States Attorney,  
Yakima, Washington, 98901.

RONALD R. HULL,  
Assistant United States Attorney,  
Yakima, Washington, 98901.

ROGER P. MARQUIS,  
ROBERT M. PERRY,  
Attorneys, Department of Justice,  
Washington, D. C., 20530.

---

---

FILED

U.S. DISTRICT COURT

YAKIMA, WASHINGTON



	Page
Opinion below -----	1
Jurisdiction -----	1
Questions presented -----	2
Statement -----	2
Statute involved -----	10
Summary of argument -----	11
Argument:	
I. The district court properly instructed the jury that enhancement in value created by the United States in constructing the project for which the land is taken cannot be considered in determining its just compensation -----	13
II. The district court correctly refused the requested instruction on substantive state law -	17
III. Appellant is not entitled to compensation under the guise of severance damage for business losses because of the change of access to the highway -----	19
Conclusion -----	27

### CITATIONS

ases:

<u>J. A. Tobin Construction Company v. United States</u> , 343 F.2d 422 -----	16
<u>Kimball Laundry Co. v. United States</u> , 338 U.S. 1 -	24
<u>Mitchell v. United States</u> , 267 U.S. 341 -----	26
<u>Omnia Co. v. United States</u> , 261 U.S. 502 -----	26
<u>Ralph v. Hazen</u> , 93 F.2d 68 -----	26
<u>Shoemaker v. United States</u> , 147 U.S. 282 -----	16
<u>Simmonds v. United States</u> , 199 F.2d 305 -----	27
<u>State of Washington v. United States</u> , 214 F.2d 33, cert. den., 348 U.S. 862 -----	17



## Cases cont'd:

## Page

<u>Stipe v. United States</u> , 337 F.2d 818 -----	25
<u>United States v. Certain Parcels of Land, Etc.</u> , 144 F.2d 626 -----	17
<u>United States v. Cors</u> , 337 U.S. 325 -----	16
<u>United States v. Grand River Dam Authority</u> , 363 U.S. 229 -----	26
<u>United States v. Grizzard</u> , 219 U.S. 180 -----	13, 23
<u>United States v. Ham</u> , 187 F.2d 265 -----	20
<u>United States v. Hayes</u> , 172 F.2d 677 -----	27
<u>United States v. Miller</u> , 317 U.S. 369 -----	16, 17
<u>United States v. Petty Motor Co.</u> , 327 U.S. 372 ---	26
<u>United States v. Whitehurst</u> , 337 F.2d 765 -----	16
<u>United States v. 93,970 Acres of Land</u> , 360 U.S. 328 -----	17
<u>United States v. 2,635.04 Acres of Land, Etc.</u> , 336 F.2d 646 -----	27
<u>United States ex rel. T.V.A. v. Powelson</u> , 319 U.S. 266 -----	26
<u>Wendell S. Wilson, et al. v. United States</u> , (C.A. 10, No. 7867, Sept. 1, 1965) -----	19
<u>Winn v. United States</u> , 272 F.2d 282 -----	13, 24

## Statutes:

23 U.S.C. sec. 107(a) -----	14
RCW 47.52.080 -----	17

FOR THE NINTH CIRCUIT

---

No. 20114

GEORGE L. BOCK, Appellant

v.

UNITED STATES OF AMERICA, Appellee

---

APPEAL FROM THE UNITED STATES DISTRICT COURT  
FOR THE EASTERN DISTRICT OF WASHINGTON,  
SOUTHERN DIVISION

---

BRIEF FOR THE UNITED STATES

---

OPINION BELOW

The district court did not write an opinion.

JURISDICTION

This is an appeal filed February 23, 1965 (1 R. 111),<sup>1/</sup>  
on a judgment on verdict (1 R. 104-109) filed on January 12,  
1965, awarding just compensation for the property condemned by  
the United States in the total amount of \$3,652. The jurisdic-  
tion of the district court was invoked by the United States  
under 28 U.S.C. sec. 1358 (1 R. 1-5). The jurisdiction of this  
court is invoked under 28 U.S.C. sec. 1291.

---

The record is in two volumes, Volume 1 containing the  
pleadings and Volume 2 the transcript of the testimony.  
They will be referred to herein as "1 R." and "2 R."

### QUESTIONS PRESENTED

1. Whether the jury was properly instructed regarding the enhancement in value created by the government project.
2. Whether the district court properly refused a requested instruction regarding the application of a state statute.
3. Whether the landowner is entitled to compensation, under the guise of severance damage, for business losses because of the change of highway access.

### STATEMENT

On June 20, 1962, the United States instituted proceedings to condemn certain parcels of land which belonged to appellant for construction and improvement of Washington State Highway Project UI-82-2 (5), a portion of the National System of Interstate and Defense Highways, being constructed in accordance with standards, including control of access, adopted by the Secretary of Commerce, Bureau of Public Roads (1 R. 6), in cooperation with the State Highway Departments

2/  
(1 R. 1-12). A Pre-Trial Order, dated November 20, 1964, sets out the agreed facts of this case (1 R. 42-43). Appellant's land is located just outside the southeast city limits of Yakima. The tract is almost rectangular in shape, consisting of a total of 2.77 acres. The north boundary of the land extends approximately 420 feet abutting Secondary State Highway 11-A, which constitutes an extension of East Lenox Avenue (2 R. 36-37, 48-50). A diagram shows the land's relation to the new freeway.

---

2/ The Secretary of Commerce is authorized to acquire land, including the control of access for the federal-state highway project in question, under the Act of August 1, 1888, 25 Stat. 357, 40 U.S.C. sec. 257; the Act of February 26, 1931, 46 Stat 1421, 40 U.S.C. secs. 258(a) to (e); and Section 109 of the Federal-Aid Highway Act of 1956, 70 Stat. 374, as codified August 27, 1958, 72 Stat. 893, 23 U.S.C. sec. 107.



Exit Freeway

Enters Freeway

Freeway

11-A

Enters Freeway

Freeway (U.S. Highway 82)

Exit Freeway

Parcel A  
0.22 acre

Secondary State Highway 11-A (East Leg)  
New Access  
Parcel B  
Parcel C  
2.36 acres  
Back

Old access

Old driveway



Several old frame buildings are located on the property and appellant lives in one of the buildings, which is also utilized for storage (2 R. 49-50). Appellant used most of the land for truck gardening and operated a retail vegetable business on the premises (2 R. 49, 52, 181).

Before the government taking, appellant's driveway entered the Old Highway 11-A with a right-of-way access approximately 30 feet wide. Although appellant had a right of access to the Old Highway 11-A from any point of his property, the 30-foot-wide access was the only right of way granted by the State Highway Department. The remainder of the abutting land was five or six feet below the surface of the Old Highway 11-A (2 R. 21-22, 29, 40-41, 106-107).

The project basically is that of a freeway comprising a portion of U.S. Highway 82 which affords a bypass east of the city, running in a north and south direction. The other portion of the project involves Secondary State Highway 11-A which runs in an east and west direction and intersects, by way of an overpass, U.S. Highway 82.



Appellant's land is located in the vicinity of this intersection and the project required a curving access road to cross the northwest corner of appellant's tract, affording access between Secondary State Highway 11-A and U.S. Highway 82, a common point of access for all traffic. Therefore, Secondary State Highway 11-A was improved into a limited access highway becoming a part of the cross-state pattern (2 R. 10-14, 29-30; Ex. No. 4). Consequently, appellant's original 30-foot-wide access driveway into Old Highway 11-A was closed and the Highway Department constructed for appellant an access road extending the old driveway along the north boundary of his tract into the curving portion of the access road located in the northwest corner thereof, which afforded appellant with a 42-foot-wide access abutting Secondary State Highway 11-A. A vehicle coming off Secondary State Highway 11-A may enter appellant's land from either direction (2 R. 23-26; Ex. No. 3).

The declaration of taking was filed on June 20, 1962 (1 R. 7-12), and consisted therefore of three parcels as follows

Parcel A: consisting of 0.22 of an acre in fee; the triangular area within the north-west corner of appellant's land upon which has been located the curved portion of the highway access road abutting Secondary State Highway 11-A.

Parcel B: consisting of 0.19 of an acre upon which a temporary easement was acquired up to a three-year period for use in connection with the project construction and upon which a permanent access road was constructed along appellant's north boundary for his use and maintenance affording access to Parcel A, thence to Secondary State Highway 11-A.

Parcel C: consisting of an easement of the balance of the appellant's ownership, a 2.36-acre remainder from the original 2.77-acre tract. Acquisition includes all existing statutory abutters' rights or easements for access to Secondary State Highway 11-A, excepting the opening across Parcel B into Parcel A.

On November 20, 1964, a jury trial was held to determine just compensation for the tract, commencing with a view of the premises (1 R. 37; 2 R. 210).

The Government called two expert appraisal witnesses to testify as to the market value of appellant's tract. The first, Warren Echles, District Senior Appraiser, Department of

Highways (2 R. 43), valued appellant's whole tract before the taking at \$5,155, and after the taking at \$3,311, concluding that the fair market value of the parcels taken was \$1,844. He arrived at this value by utilizing comparable sales in the vicinity (2 R. 59-74, 87). He further testified that the highest and best use of the tract was the existing use (truck gardening and roadside market), along with some limited type commercial operation (2 R. 55). He further said that the taking, including the restriction of access, did not materially change such use (2 R. 57-58).

The other government appraisal witness, Ben Lombard, a licensed appraiser and member of a private real estate agency, also testified that the highest and best use of the property had not changed as a result of the taking (2 R. 105, 131). He valued the entire property before the taking at \$4,878, and after value at \$3,492, arriving at the fair market value of the parcels taken at \$1,386 (2 R. 114 and 115). He also based his value on comparable sales (2 R. 116-122).

Appellant's first witness, Marion L. Pierce, a realtor (2 R. 136), testified he used the comparable sales approach in arriving at his values (2 R. 141-142, 148-180). He gave a before value of \$23,500 and determined the after value at \$3,000 (2 R. 157). The Government presented evidence at the trial that the comparable sales utilized by this witness as the basis for his value of appellant's tract were based in fact on sales of real estate which reflected an enhanced value that was due to the government highway project (2 R. 185-188). Appellant testified on his own behalf, and estimated the value of his property before the taking at \$32,000, and a present value of \$2,000 (2 R. 182).

The jury found the just compensation for the taking to be in the sum of \$3,652, and the court entered judgment in this amount (1 R. 94, 104-109). The only specific exception to the court's instruction to the jury made by appellant at the time of trial was the court's failure to instruct the jury with regard to his proposed instruction No. 20, which concerned a statute of the State of Washington providing for compensation for loss of adequate access of business property



abutting a highway (2 R. 215-216). It was only in appellant's motion for new trial that error was alleged in the court's failure to submit his other proposed instructions (1 R. 103).

The appellant now appeals, alleging the court erred in failing to submit to the jury his proposed instructions Nos 4, 6, 12, 13, 14 and 20 (Br. 3-6).

Additional evidence will be discussed in the Argument, supra.

#### STATUTE INVOLVED

23 U.S.C. sec. 107(a) provides:

In any case in which the Secretary is requested by a State to acquire lands or interests in lands (including within the term "interests in lands", the control of access thereto from adjoining lands) required by such State for right-of-way or other purposes in connection with the prosecution of any project for the construction, reconstruction, or improvement of any section of the Interstate System, the Secretary is authorized, in the name of the United States and prior to the approval of title by the Attorney General, to acquire, enter upon, and take possession of such lands or interests in lands by purchase, donation, condemnation, or otherwise in accordance with the laws of the United States (including the Act of February 26, 1931, 46 Stat. 1421), if--

(1) the Secretary has determined either that the State is unable to acquire necessary lands or interests in lands, or is unable to acquire such lands or interests in lands with sufficient promptness; and

(2) the State has agreed with the Secretary to pay, at such time as may be specified by the Secretary an amount equal to 10 per centum of the costs incurred by the Secretary, in acquiring such lands or interests in lands, or such lesser percentage which represents the State's pro rata share of project costs as determined in accordance with subsection (c) of section 120 of this title.

The authority granted by this section shall also apply to lands and interests in lands received as grants of lands from the United States and owned or held by railroads or other corporations.

## SUMMARY OF ARGUMENT

### I

The evidence clearly establishes that the reconstruction of Secondary State Highway 11-A was just as much a part of the United States project as U.S. Highway 82. The district court properly instructed the jury not to consider the enhancement in value of appellant's property created by the improvement of Secondary State Highway 11-A after the United States became



committed to the project. Appellant's proposed instruction directing the jury to consider such "after values" is contrary to well-established law.

## II

The district court correctly refused to instruct the jury regarding the statute of the State of Washington because this statute, in that it prescribes a measure of compensation, is a matter of substantive right as distinguished from a procedural mandate, and the law is clear that federal law alone controls here. Appellant's rights were protected in the condemnation proceedings regardless of the state statute.

## III

Appellant is not entitled to compensation under the guise of severance damage for business losses because of the change of access to the highway. There was substantial evidence presented at the trial of this case showing that the change of access was adequate and did not affect the fair market value of appellant's remaining tract.

Since appellant's access was not damaged or destroyed, situation is distinguishable from United States v. Grizzard, U.S. 180 (1911), and the other cases quoted by appellant. Appellant is rather in the exact position depicted by this case in Winn v. United States, 272 F.2d 282 (1959). Just because the access may not be what appellant considers "direct access" does not by this fact alone entitle him to compensation. Accordingly, any loss in the business character of the property as alleged by appellant must be deemed damnum absque reparacione.

## ARGUMENT

### I

THE DISTRICT COURT PROPERLY INSTRUCTED  
THE JURY THAT ENHANCEMENT IN VALUE  
CREATED BY THE UNITED STATES IN  
CONSTRUCTING THE PROJECT FOR WHICH THE  
LAND IS TAKEN CANNOT BE CONSIDERED IN  
DETERMINING ITS JUST COMPENSATION

Appellant contends that the trial court erred in refusing to submit his proposed instruction No. 6, which reads as follows (1 R. 70; Br. 3):

I instruct you that while you may not consider U.S. Highway 82 as contributing to the value of this property you may, however, consider the contribution to value made by State Highway 11A, the Lenox Avenue Overpass and other developments aside from U.S. Highway 82 in arriving at your evaluation of the expert's testimony and in arriving at the award in this case.

It is clear from the record of this case that the reconstruction of Secondary State Highway 11-A became just as much a part of the United States project as U.S. Highway 82. The Secretary of Commerce, acting under the provisions of 23 U.S.C. sec. 107(a) (supra, pp. 10-11), through the Bureau of Public Roads, determined that the described parcels of appellant's land were needed in order to complete the Interstate System (1 R. 6). The declaration of taking (1 R. 7-12) clearly specifies that the described parcels of appellant's tract were taken for public use because of the necessity to provide adequately for construction, reconstruction, and improvement of Washington Highway Project UI-82-2(5), a portion of the national system of Interstate and Defense Highways, being constructed in accordance with standards, including control of access, adopted by the Secretary of Commerce in cooperation with the State Highway Department.

Government witness, Charles Chapman, a project engineer with the State of Washington Highway Department, testified as follows (2 R. 10):

BY MR. HULL:

\* \* \* \* \*

Q. And do you know when the Federal-State project through here was approved?

A. It was approved on -- in July I believe of 1958.

Q. 1958. Now is the -- there has been some improvement, has there, of the secondary State Highway 11-A which is the continuation from east -- out east toward Moxee and beyond? Is that part of the Federal-State Highway project as well?

A. Yes. <sup>3/</sup>

Of course, traffic access to the interstate freeway at limited points is just as much a part of the freeway project as other portions of the road. As the diagram makes obvious, some rearrangement of State Highway 11-A was necessary to complete the interchange.

---

/ The court reporter erroneously left this answer out in transcribing the proceedings.



10

The law is well settled that the value of the land condemned is to be ascertained as of the date of the government taking and that the United States does not pay an enhanced value for condemned property when the enhancement is created by the very project for which the land is needed. Shoemaker v. United States, 147 U.S. 282 (1893); United States v. Miller, 317 U.S. 369 (1943); United States v. Cors, 337 U.S. 325 (1949); United States v. Whitehurst, 337 F.2d 765 (C.A. 4, 1964); J. A. Tobin Construction Company v. United States, 343 F.2d 422 (C.A. 10, 1965). Hence, the trial court did not err by not submitting the instruction because it would be directing the jury to consider any enhancement in value of the property condemned after the Government became committed to the project.

We submit, therefore, that the following instruction that was given by the trial court to the jury was adequate (2 R. 205):

In arriving at fair market value of the land in question, you must disregard increase in value, if any, due to the initiation of the Federal-State Highway Project 3-A and 11-A, or due to the proximity of the project to the subject lands, arising after the project was approved by the Director of Highways and

authorized by Congress on August 27, 1958, or due directly to the construction of the Federal-State Highway Project 3-A which began July, 1960.

## II

### THE DISTRICT COURT CORRECTLY REFUSED THE REQUESTED INSTRUCTION ON SUBSTANTIVE STATE LAW

Appellant contends that the trial court erred in submitting its proposed instruction No. 20 (Br. 5, 17), which was based on a statute of the State of Washington, RCW 52.080 (Br. 17). That statute entitled an owner of business property abutting a highway compensation for loss of adequate ingress or egress where the highway is altered.

This statute, in that it prescribes a measure of compensation, is a matter of substantive right, and federal law alone controls in the determination thereof. United States v. Miller, 317 U.S. 369 (1943); United States v. 93.970 Acres of Land, 360 U.S. 328 (1959); State of Washington v. United States, 214 F.2d 33 (C.A. 9, 1954), cert. den., 348 U.S. 82; United States v. Certain Parcels of Land, Etc., 144 F.2d 2 (C.A. 3, 1944). The Supreme Court made this clear in the Miller case, supra, stating at pp. 379-380:



We need not determine what is the local law, for the federal statutes upon which reliance is placed require only that, in condemnation proceedings, a federal court shall adopt the forms and methods of procedure afforded by the law of the State in which the court sits. They do not, and could not, affect questions of substantive right--such as measure of compensation--grounded upon the Constitution of the United States.

Accordingly, the state statute in question, being one of substantive law as distinguished from a procedural mandate, is completely irrelevant to federal condemnation proceedings.<sup>4/</sup>

Appellant's rights were protected regardless of the state statute. In federal condemnation law, just compensation is determined by the fair market value of the property taken. An actual loss of access, being an element of value arising out of the relation of the part taken to the entire tract, entitles the owner to compensation for such taking. Here, any such loss would be reflected in the before and after values of the property that were derived from comparable sales as

---

<sup>4/</sup> As established by Point III of the Argument, infra, the record shows evidence that appellant was not deprived of adequate access. Hence, the provisions of the state statute were not violated.

established by the evidence presented. We submit that this matter was correctly before the jury and that the trial court adequately instructed on this issue (2 R. 201-202). <sup>5/</sup>

### III

#### APPELLANT IS NOT ENTITLED TO COMPENSATION UNDER THE GUISE OF SEVERANCE DAMAGE FOR BUSINESS LOSSES BECAUSE OF THE CHANGE OF ACCESS TO THE HIGHWAY

Appellant complains his entire direct access to Secondary State Highway 11-A was destroyed and taken by these proceedings and that the business character of his property, which had great potential, was destroyed (Br. 9). The case boils down into one in which the appellant is seeking, under the guise of severance damages, compensation for business losses because of the change of access to the highway. The

---

There was no reversible error committed by the trial court in not giving appellant's proposed instructions Nos. 4, 12, 13 and 14 (Br. 3-5, 13-14). A review of the instructions submitted to the jury (2 R. 200-206) will clearly show that the trial court substantially and adequately covered the ~~above-~~ requested instructions. In reviewing instructions, they must be considered as a whole and not piecemeal or by taking excerpts from the remainder. Wendell S. Wilson, et al. v. United States (C.A. 10, No. 7867, Sept. 1, 1965), not yet reported. Here, the appellant's requested instructions simply amounted to a repetition of what the trial court had already covered, and there is no error in the instructions as given.

question for determination by the jury is the market value of the property to be taken, not the damage to the business of appellant in operating that property. United States v. Ham, 187 F.2d 265, 271 (C.A. 8, 1951). There was substantial evidence presented at the trial of this case establishing that the appellant's access was not damaged or destroyed and that he was afforded adequate access to Secondary State Highway 11-A, and that this change in access did not affect the fair market value of the land. An extract of the record shows:

Government witness Chapman testified as follows

(2 R. 24, 26):

BY MR. HULL:

Q. As constructed now, is it possible for a large vehicle coming off the Bock property to make a turn onto 11-A in either direction?

A. It is.

Q. Is it possible for a large vehicle coming from, say, Yakima to make a turn here and go onto the Bock property?

A. It is.

Q. How large a vehicle?

A. Those radii are designed to contain the movement of trucks and semi-trailers.

\* \* \* \* \*

Q. [In referring to dimensions of new access] Is that in accordance with State Highway and Federal Highway standards considered an adequate access for large vehicles or normal traffic, and considering that the width at the highway abutment is forty-two feet? Is that considered a reasonable access --

A. Yes, it is.

Q. -- for normal traffic?

A. It is.

Government witness Echles testified as follows

R. 55, 56, 57-58):

BY MR. HULL:

Q. What in your opinion as of the date of taking in June, June 20, 1962, was the highest and best use of the subject property?

A. In my opinion, the best use was the existing use, along with some limited type commercial operation.

\* \* \* \* \*



Q. Are you familiar also with the fact that access from this property to Highway 11-A has now been limited to the access portion within Tract A, or Part A, and the balance of it is cut off by a fence? Are you familiar with that factor?

A. Yes.

Q. Then subsequent to such taking, what in your opinion remains the highest and best use of this property?

\* \* \* \* \*

A. I feel it would have much the same uses after the taking as before, that the existing use would not be necessarily changed, \* \* \*.

Government witness Lombard testified as follows

(2 R. 105-106):

BY MR. HULL:

Q. And what in your opinion was the highest and best use of that property just before the taking in June, 1962?

A. I would say limited to transit commercial. That is, catering to the traffic along the highway as a produce stand, or something of this nature.

Q. And after the taking in this case, in your opinion, was that best use changed?

A. Not in my opinion, no.

Q. Would you explain your reasoning in that regard?

A. Well, the traffic did not change, has not changed considerably. In fact, the volume of the traffic has possibly increased; the exposure of Mr. Bock's property from oncoming traffic was not altered too much.

Q. What do you mean by exposure?

A. Well, the exposure from oncoming traffic, either from the east or from the west would be about the same so far as cars being able to see it.

Q. I think this is a term used by men in your profession. What does exposure mean?

A. I meant by exposure, the visibility of the property by oncoming cars.

Q. You say that is not altered?

A. No, they would have plenty of time to see Mr. Bock's cars -- or cars would have to see Mr. Bock's property.

Appellant did not offer any competent evidence to refute the established evidence of adequate access. The case, therefore, is clearly distinguishable from United States v. Lazzard, 219 U.S. 180 (1911), and the other cases quoted by appellant (Br. 10-19) because here there is no loss or damage



to appellant's access which affected the fair market value of the land. His access right was changed, but not damaged or destroyed, as appellant would like us to believe. Just because the access may not be what the appellant considers a "direct access" does not by this fact alone entitle him to compensation. This was clearly pointed out by the Supreme Court in Kimball Laundry Co. v. United States, 338 U.S. 1 (1949), where the Court stated (p. 5):

\* \* \* loss to the owner of nontransferable values deriving from his unique need for the property or idiosyncratic attachment to it, like loss due to an exercise of the police power, is properly treated as part of the burden of common citizenship.

Thus, appellant's situation is exactly as the case of Winn v. United States, 272 F.2d 282 (1959), where this Court points out (p. 286): "Appellants have not suffered damage 'arising out of the relation of the part taken to the entire tract.' United States v. Miller, *supra*." And, as the Court further stated (p. 287):

There is nothing to show that the Interstate as such will contribute any "direct and identifiable element of depreciation" to the residue of their property. *Boyd v. United States*, 8 Cir., 1955, 222 F.2d 493, 495. Whatever damage they may suffer results from neither the taking of the land nor the use to which it is to be put, but from the Interstate project as a whole and the consequent diversion of traffic. Construction of a strip of a highway on the land taken here is not such a use as to cause injury to the remainder. Appellants' claim is essentially one for business loss and is not compensable. [Citing cases.]

As in the case at bar, the change in access was not such as to cause injury to the remainder. True, the appellants may have to travel a few hundred feet farther than the old access but, as pointed out in the *Winn* case, *supra*, at page 287, such inconvenience is not compensable.

A similar case, *Stipe v. United States*, 337 F.2d 813 (C.A. 10, 1964), also concerned a change of access to business property abutting a relocated highway, and the court said (at p. 821):

Although perhaps not as desirable or convenient as it was before, access was provided to the relocated and changed highways. The record as a whole discloses beyond any doubt that the decrease in the value of the business resulted not from the taking of part of Stipe's land, but from the relocation of Highway 69, which diverted traffic over the highway away from the business operation. Whatever his loss, it is due to the destruction or frustration of his business, and not the taking of the property. Such losses are not compensable. [Citing cases.]

Accordingly, any loss in the business character of the property as alleged by the appellant must be deemed to be a claim for business loss under the guise of severance damage. Such loss is not compensable, being what is known as 'damnum absque injuria.' Omnia Co. v. United States, 261 U.S. 502 (1923); Mitchell v. United States, 267 U.S. 341 (1925); Ralph v. Hazen, 93 F.2d 68 (C.A. D.C. 1937); United States ex rel. T.V.A. v. Powelson, 319 U.S. 266 (1943); United States v. Petty Motor Co., 327 U.S. 372 (1946); United States v. Grand River Dam Authority, 363 U.S. 229 (1960).

Where a jury returns a verdict in a condemnation case which is within the range of competent testimony, it cannot be said to be against the weight of the evidence. It is not the

function of a reviewing court to retry the facts and substitute  
its judgment for that of the jury. United States v. 2,635.04  
Acres of Land, Etc., 336 F.2d 646, 649 (C.A. 6, 1964); Simmonds  
United States, 199 F.2d 305, 307 (C.A. 9, 1952); United  
States v. Hayes, 172 F.2d 677, 680 (C.A. 9, 1949).

#### CONCLUSION

For the foregoing reasons, it is respectfully sub-  
mitted that the judgment of the district court should be  
affirmed.

Respectfully,

EDWIN L. WEISL, JR.,  
Assistant Attorney General.

FRANK R. FREEMAN,  
United States Attorney,  
Yakima, Washington, 98901.

RONALD R. HULL,  
Assistant United States Attorney,  
Yakima, Washington, 98901.

ROGER P. MARQUIS,  
ROBERT M. PERRY,  
Attorneys, Department of Justice,  
Washington, D. C., 20530.

TOBER 1965



## CERTIFICATE OF EXAMINATION OF RULES

I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with these rules.

---

ROBERT M. PERRY,  
Attorney, Department of Justice,  
Washington, D. C., 20530.





No. 20114

---

In the  
United States Court of Appeals  
For the Ninth Circuit

---

UNITED STATES OF AMERICA,  
*Appellee,*

vs.

2.45 ACRES OF LAND, more or less,  
in Yakima County, Washington,  
and GEORGE L. BOCK, et al.,  
*Appellant.*

No. 20114

---

REPLY BRIEF OF APPELLANT

---

KENNETH C. HAWKINS  
*Attorney for Appellant*

419 Miller Building  
Yakima, Washington

---

FRANKLIN PRESS  YAKIMA, WASH.

FILED

DEC 1 1965

FRANK H. SCHMID, CLERK



## SUBJECT INDEX

	<i>Page</i>
STATEMENT .....	1
ARGUMENT .....	2
I. Increment Values .....	2
II. Substantive State Law .....	3
III. Reply to Respondent's Argument that Appellant is Not Entitled to Compensation Under the Guise of Severance Damage for Business Losses Because of the Change of Access to the Highway .....	7
CONCLUSION .....	8

## TABLE OF AUTHORITIES CITED CASES

State of Washington v. United States, 214 F. (2d) 33, (C.A. 9, 1954), at p. 39 .....	3
United States v. 93.970 Acres of Land, 360 U. S. 328 (1959), p. 332 .....	5
United States v. Certain Parcels of Land, etc., 144 F. (2d) (C.A. 3, 1944) at p. 628 .....	6
United States v. Grizzard, 219 U. S. 180 (1911) ..	7
United States v. Miller, 317 U. S. 369 (1943), at p. 379 .....	4

## STATUTES

R.C.W. 47.52.080 .....	3
------------------------	---



# In the United States Court of Appeals For the Ninth Circuit

---

UNITED STATES OF AMERICA,

*Appellee,* )

vs.

No. 20114

2.45 ACRES OF LAND, more or less,  
in Yakima County, Washington,  
and GEORGE L. BOCK, et al.,

*Appellant.* )

REPLY  
BRIEF OF  
APPELLANT

---

## STATEMENT

Respondent sets forth on page 4 of its brief a map which is not an exhibit in the case and is indicated as not being drawn to scale; however, it is clear from this map that east of the freeway exit is not a portion of the U. S. Highway 82 project, which is the project that justified the jurisdiction of the Federal court. Secondary State Highway 11A is not a Federal project. State Highway 11A turns north at First Street in Yakima. An overpass over the railroad tracks recently constructed after much public controversy opening up easy access to the west side of the city of Yakima is not a part of the state highway system, but is simply a city of Yakima project, and by no stretch of the imagination constitutes a part of U. S. Highway 82. Limiting access from the subject property to Secondary State Highway



11A east of the freeway entrances and exits was purely a state item and in no wise involved Federal jurisdiction.

## ARGUMENT

### I

#### Increment Values

The respondent here contends that appellant's proposed instruction No. 6 does not properly state the law since the jury cannot take into consideration value created by the United States in constructing the project for which the land is taken. Here respondent completely misconceives the facts: The Lenox Avenue overpass is strictly a City of Yakima project. It is not a state highway project. Least of all is it a Federal project. It in no wise is a portion of U. S. Highway 82. It was, however, a project for which contracts had been let by the City of Yakima at the time of the trial. Certainly the jury was entitled to take into consideration the Lenox Avenue overpass in arriving at the value of this project. Counsel's argument is based entirely upon a misconception of the facts. Likewise, the state of Washington was building a bridge across the Columbia River upon which State Highway 11A crossed to reach the rich Columbia Basin and Palouse agricultural districts. Again, this was in no wise any portion of U. S. Highway 82, and I do not believe that counsel, Mr. Hull, would make any such contention to this court. Since the argument of respondent is based entirely

upon a misconception of the facts, the cases cited on page 16 of their brief are therefore simply not in point.

## II

### Substantive State Law

One of appellant's principal points is that the statute RCW 47.52.080 referred to in our opening brief on page 17 creates a vested property right in the property owner. To permit other land to be taken in state court abutting upon appellant's land and given values based upon the vested rights created by said statute, and then in this action to deprive the appellant of the same treatment, constitutes discrimination not contemplated by the Federal statutes, or Constitution.

The cases cited by the respondent, it is submitted, are not in point with respect to the specific issue here involved. In the case of *State of Washington v. United States*, 214 F. (2d) 33 (C.A. 9, 1954) cited on page 17 of respondent's brief, this court was confronted by a controversy between the United States and the State of Washington over the question of whether or not the state should be compensated for a road which was in the area condemned and taken by the government for the establishment of the Hanford works. In such a situation the measure of compensation is the cost of providing any necessary substitute. The court in that case set aside a \$500,000.00 verdict upon the grounds that there was no sufficient evidence to justify the submission of the issue to a jury. On the question whether

state or Federal law applies, this court stated, page 39:

“There is no real dispute about the applicable law concerning condemnation of roads and highways. Both parties cite and rely upon many of the same cases. The overwhelming weight of modern authority is to the effect that a municipality, a county, a state, or other public entity is entitled to compensation for the taking of a street, road or other public highway only to the extent that as a result of such taking it is compelled to construct a substitute highway.”

It is obvious that the foregoing case has no relation whatsoever to the issue in the case at bar.

Respondent also cites the case of *United States v. Miller*, 317 U. S. 369 (1943), also at page 17 of respondent's brief. This case arose by reason of the taking of property in the state of California. It was contended by the property owner in that case that the California rule that increase in value of the subject property due to the construction contemplated by the taking was an element to be considered by the jury in determining fair market value. With that specific issue before it, the Supreme Court stated, page 379:

“\* \* \* They claim that the California rule is settled that fair market value at the date of taking is the standard of value without elimination of any increment attributable to the action of the taker. We need not determine what is the local law for the Federal statutes upon which reliance is placed require only that in condemnation proceedings a Federal Court shall adopt the forms and methods of procedure afforded by the law of the state in which the Court sits. They do not and could not affect questions of substantive right such as the measure of compensation grounded upon the Constitution of the United States.”

A consideration of the exact issue before the Supreme Court and the language used by the Supreme Court dictates the conclusion, namely that the measure of compensation is to be determined by Federal law. But this does not say, and does not pretend to say, that property rights vested in the property owner by the statutes of the state may be taken without compensation. The case cited thus does not meet the issue posed by appellant's position. It is not the measure of compensation that is in issue, but whether a vested right can be taken without compensation.

Respondents next cite *United States v. 93.790 acres of land*, 360 U. S. 328 (1959). This case involves the issue whether or not the United States can revoke a lease and then commence condemnation proceedings. The argument of the property owner was that having commenced condemnation, the United States had made an election which forbade its revoking a lease, and therefore had to pay compensation for the leasehold interest. The court said, page 332:

"Respondents argue, however, that the election of remedies is part of the law of Illinois and that Illinois law applies here \* \* \* We have often held that where essential interests of the Federal government are concerned Federal law rules unless Congress chooses to make state laws applicable. It is apparent that no such choice has been made here."

We have here simply an interpretation of a Federal statute pertaining to a specific activity of the Federal government relating to the operation of airports and

leases thereon. It is obvious that this case has no bearing upon the issues submitted here.

Finally, the respondent cites the case of *United States v. Certain Parcels of Land, etc.*, 144 F. (2d) 626 (C.A. 3, 1944) also on page 17 of respondent's brief. In that case the issue was simply this: Under Pennsylvania law the price at which the subject property was sold at a prior time was inadmissible for the purpose of determining fair market value. Under Federal law where the sale is within a reasonable time such price is admissible for the purpose of determining fair market value. The court stated, page 628:

"The question is presented, however, whether the Pennsylvania concept of value for purposes of eminent domain governs in a condemnation proceeding brought by the United States against land in Pennsylvania."

The issue is similar to the issue in the Miller case cited above, and the court cited the Miller case and held that the measure of compensation was determined by Federal law and not the law of the state—which in this case again was a court made rule of evidence as to what was material in an issue determining fair market value. Again we point out that this case does not meet the issue whether the government can take a right vested in the property owner by the laws of the state without compensation.

It is submitted that the cases cited by respondent upon this important issue are simply not in point.



## III

**Reply to Respondent's Argument That Appellant Is Not  
Entitled to Compensation Under the Guise of Sever-  
ance Damage for Business Losses Because of the  
Change of the Access to the Highway**

Commencing on page 19 of respondent's brief the argument is made that while appellant is entitled to compensation by reason of the taking of the access on Secondary State Highway 11-A that the jury was bound to accept the government's witnesses' views that an adequate substitute, although be it twice removed from Highway 11-A, was adequate. The appellant, of course, denied this and testified that the complete elimination of access directly from 11-A to his property had a direct and devastating effect upon the market value of his property. Thus it became an issue of fact to be determined by the jury as to the exact amount of this effect of the taking of such access. Respondent's only contention seems to be that the jury was bound to accept the government's testimony, which of course is not and could not be the law in view of the contrary evidence submitted by the respondent. Obviously then the case of *United States v. Grizzard*, 219 U. S. 180 (1911) and the other cases cited by appellant on pages 10 to 19 of appellant's brief are immediately in point. On page 25, respondent makes a statement of fact without qualification, which is illustrative of our argument here. Respondent states:



“As in the case at bar, the change in access was not such as to cause injury to the remainder.”

Such a statement is so completely contrary to the undisputed as well as the disputed evidence it is difficult, to put it mildly, to follow respondent's argument. It is respectfully submitted that respondent's argument here, based as it is upon such untenable assumptions of fact, is without merit.

### CONCLUSION

It is respectfully submitted that respondent's brief does not meet or answer the points made by the appellant. The case should be remanded for a new trial in order that the appellant may be adequately compensated for the vested property rights taken and the damages sustained.

Respectfully submitted,  
KENNETH C. HAWKINS  
*Attorney for Appellant*

No. 20114

---

In the  
United States Court of Appeals  
For the Ninth Circuit

---

UNITED STATES OF AMERICA,  
*Appellee,*

vs.

2.45 ACRES OF LAND, more or less,  
in Yakima County, Washington,  
and GEORGE L. BOCK, et al,  
*Appellant.*

No. 20114

---

BRIEF FOR APPELLANT

---

KENNETH C. HAWKINS  
*Attorney for Appellant*

419 Miller Building  
Yakima, Washington

FILED  
SEP 10  
FRANK H. SCHMID, CLERK



## SUBJECT INDEX

	<i>Page</i>
Judgment Below .....	1
Statement .....	1
Specification of Errors .....	3
Summary of Argument .....	6
Appellant's Argument .....	8
I. Contributions to Value by Other Improvements .....	8
II. Fair Market Value .....	12
III. Owner's Existing Access Rights .....	15
Conclusion .....	20

## TABLE OF AUTHORITIES

### CITED CASES

Bartholomae v. U. S., 253 F. (2d) 713, 73 ALR (2d) 1293 .....	18
Brownlow v. O'Donoghue Bros., 276 Fed. 636 .....	18
Chelan Electric Company v. Perry, 268 P. 1040, 148 Wash. 353, 49 S. Ct. 478, 279 U.S. 823, 73 L. Ed. 977 .....	12
Donovan v. Penn Co., 199 U. S. 279, 50 L. Ed. 192, 26 S. Ct. 91 .....	18
Duckett v. U. S., 266 U. S. 149, 69 L. Ed. 216, 45 S. Ct. 38 .....	18
Ham, et al, v. Northern Pacific Railway Company, 181 P. 898, 107 Wash. 278, at pg. 386 and 389 .....	11
Little Rock Junction Railway v. Woodruff, 49 Ark. 381, 5 S.W. 792, 1 Orgel 90 .....	14
Lockwood v. Portland, 988 Fed. 480 .....	17
People v. Riciardi, 23 Cal. (2d) 390, 144 P. (2d) 799 .....	15
Phyllis v. U. S., 243 F. (2d) 1 .....	18

	<i>Page</i>
Polsun Log and Coal v. U. S., 160 F. (2d) 712	18
Sacramento Southern Railway Co. v. Heibron, 104 Pac. 979, 156 Cal. 408	14
Sanitary District v. Baumbach, 270 Ill. 128, 110 N. E. 331	14
Schiefelbein v. U. S., 124 F. (2d) 945, at p. 947	19
Seattle and Montana Railroad Co. v. Roeder, 30 Wash. 244, 111 Pac. 206	10
U. S. v. First National Bank, 250 F. 299	11
U. S. v. Grizzard, 219 U. S. 180, 55 L. Ed. 165, 31 S. Ct. 162	18
Viliborgli v. School District, 55 Ariz. 230, 100 P. (2d) 178	15
Winn v. U. S., 272 F. (2d) 282	17

## TEXTBOOKS

72 Stat. 893	1
23 U. S. C. 107	1
29 C. J. S., Sec. 137, p. 574	14
1 Orgel 95	15

## STATUTES

R. C. W. 47.52.080	2, 3, 5, 17
--------------------	-------------

In the United States Court of Appeals  
For the Ninth Circuit

UNITED STATES OF AMERICA,

*Appellee,*

vs.

No. 20114

2.45 ACRES OF LAND, more or less,  
in Yakima County, Washington,  
and GEORGE L. BOCK, et al,

*Appellant.*

BRIEF OF  
APPELLANT

JUDGMENT BELOW

The judgment below is based upon a verdict of a jury, the judgment and the verdict being found on page 104 of the transcript. The jurisdiction of the court is based upon the Act of Congress approved August 1, 1888, the Act of February 26, 1931, and the Act of August 27, 1958, authorizing the acquisition of land required for right of way in connection with the improvement of any section of the national system of interstate and defense highways (72 Stat. 893; 23 U. S. C. 107).

STATEMENT

This action was instituted by the United States of America to acquire a right of way for the construction of Interstate Highway 82 (Tr. 1). The property of appellant lies at the intersection of said Interstate Highway 82 and State Highway 11A. State Highway 11A runs generally in an easterly and westerly direction, while Interstate Highway 82 runs generally northerly and southerly connecting Ellensburg, Wash-



ington, with Pendleton, Oregon. State Highway 11A serves the Yakima Valley and the Columbia Basin with an eventual passage through Idaho, utilizing Lolo Pass (II R. 37 et seq.). The plan of construction called for the taking and limiting access from appellant's property to State Highway 11A, Interstate Highway 82 being a new highway, and *no access was provided from appellant's property directly to or from the frontage upon Interstate Highway 82, nor upon State Highway 11A*, (Ex. 2). Prior to the taking in question, appellant operated a vegetable garden and vegetable stand (II R. 181). Passersby from Yakima and Moxee and beyond utilized full access from State Highway 11A to appellant's property for commercial purposes. The take here, taking access from appellant's property to the state highway and denying appellant access to the interstate highway, destroyed the character of the property as commercial property and left a relatively small tract no longer suitable for vegetable stand or garden operations, leaving access jointly with Yakima's disposal plant (II R. 13). Under the laws of the state of Washington, R.C.W. 47.52.080, the owner of such property was entitled to damages taking into consideration the fact that said property was commercial property. The statute reads as follows:

"No existing public highway, road or street shall be constructed as a limited access facility except upon the waiver, purchase, or condemnation of the abutting owner's right of access thereto as herein provided. In cases involving existing highways, if

the abutting property is used for business at the time the notice is given as provided in RCW 47.52.072, the owner of such property shall be entitled to compensation for the loss of adequate ingress to or egress from such property as business property in its existing condition at the time of the notice provided in RCW 47.52.072 as for the taking or damaging of property for public use."

The trial court declined to submit any instruction based upon that statute and declined to submit to the jury any issue of damages as a result of the loss of adequate ingress to and egress from such property as business property (I R. 84; II R. 196). The case was tried and submitted to a jury, the verdict being wholly inadequate from the standpoint of appellant.

### SPECIFICATION OF ERRORS

1. The trial court failed to give appellant's proposed Instruction No. 6, which reads as follows (I R. 70):

"I instruct you that while you may not consider U. S. Highway 82 as contributing to the value of this property you may, however, consider the contribution to value made by State Highway 11A, the Lenox Avenue Overpass and other developments aside from U. S. Highway 82 in arriving at your evaluation of the expert's testimony and in arriving at the award in this case."

While it is true that the improvement for which the property is taken cannot be considered as contributing to the value, other existing and imminent developments may be considered (II R. 215).

2. The trial court erred in failing to give appellant's

proposed instructions 4, 12, 13, and 14, which read as follows:

“Instruction No. 4

“You are instructed that by fair market value is meant the highest amount of money which in fair and unhurried negotiations, a well-informed purchaser, willing but not obliged to buy the property, would pay to a well-informed seller, willing but not obliged to sell it, taking into consideration all uses, including its highest and best use, to which the property is adapted and might in reason be applied. It means neither a panic price, speculative value nor a value fixed by depressed or inflated prices. Neither is it the value put on the property by the owner because of any value peculiar to him alone, nor because he may be unwilling to sell it, nor is it limited to what the property will bring at a forced sale.” (I R. 68)

“Instruction No. 12

“I instruct you the fair market value of a property means not the low or the average, but the best price obtainable on the open market by a willing seller, not compelled, nor hurried, from a willing buyer, not compelled, nor hurried, to buy.” (I R. 76)

“Instruction No. 13

“I instruct you that fair market value means the highest price obtainable on the free and open market within a reasonable time. It does not mean the price obtained at the fastest sale or the quickest sale; it can include what might be bought on contract or terms.” (I R. 77)

“Instruction No. 14

“I instruct you that fair cash market value means the highest price that a willing and informed buyer not compelled to buy would pay to a willing and informed seller not compelled to sell, each being fully informed as to its past uses, its present condition, and its potential future uses. It means the best price

obtainable on the *open market*, not the average and certainly not the lowest, by a seller, well-informed, not compelled to sell, from a buyer also well-informed, not compelled to buy.” (I R. 78)

The trial court failed to give these proposed instructions which raised the issue that the property owner in obtaining the fair market value is entitled to the highest price obtainable on the open market (II R. 215).

3. The trial court erred in failing to submit appellant’s proposed Instruction No. 20, which reads as follows (I R. 84) :

“Instruction No. 20

“I instruct you, ladies and gentlemen of the jury, that the Legislature of the State of Washington has enacted a law for the purpose of protecting an abutter’s right of access and providing for compensation for the taking thereof. This statute reads in part as follows:

“ ‘No existing public highway \* \* \* shall be constructed as a limited access facility except upon the \* \* \* condemnation of the abutting owner’s right of access thereto \* \* \*. In cases involving existing highways, if the abutting property is used for business at the time the notice is given as provided in RCW 47.52.072 [which in this case was on or shortly after June 30, 1962] the owner of such property shall be entitled to compensation for the loss of adequate ingress to or egress from such property as business property \* \* \*’.”

Under the laws of the State of Washington, R.C.W. 47.52.080, the owner is entitled to damages taking into consideration the fact that said property was commercial property when he is deprived of direct access upon an existing highway. This statute reads as follows:

“No existing public highway, road or street shall be constructed as a limited access facility except upon the waiver, purchase, or condemnation of the abutting owner’s right of access thereto as herein provided. In cases involving existing highways, if the abutting property is used for business at the time the notice is given as provided in RCW 47.52.072, the owner of such property shall be entitled to compensation for the loss of adequate ingress to or egress from such property as business property in its existing condition at the time of the notice provided in RCW 47.52.072 as for the taking or damaging of property for public use.”

Thus, in the State of Washington in cases involving existing highways, if the abutting property is used for business, the owner is entitled to compensation for loss of adequate ingress to or egress from such property as business property. This was a vested property right in the appellant for which he was entitled to compensation. Failure to give this instruction has the effect of taking such vested property right without compensation (II R. 216).

4. The court erred in denying the appellant’s motion for new trial (I R. 110) for the reasons above stated.

5. The court erred in entering judgment upon the verdict (I R. 104) for the reasons above stated.

## SUMMARY OF ARGUMENT

The court failed to give appellant’s proposed instructions raising the issue that the appellant was entitled to have submitted to the jury the question of a contribution to value of the subject property taken in these proceedings made by State Highway 11A and other



improvements thereto, except U. S. Highway 82, the project for which this condemnation proceeding was deemed necessary. These condemnation proceedings would not be justified, nor would this court have jurisdiction in connection with any taking pertaining to State Highway 11A. Jurisdiction here is afforded only by reason of the take insofar as it pertained to United States Highway 82 (I R. 6; II R. 10). Consequently, the construction of the bridge on the Columbia River resulted in building up of traffic and potential commercial demand for such property, the construction of the Lenox Overpass across the heavily traveled South First Street; likewise building up traffic along such property and creating greater demand for same as commercial property were items of moment, and issues raised by such fact should have been submitted to the jury in accordance with appellant's proposed instruction No. 6 which the trial court declined to give (I R. 70). The trial court failed to give appellant's proposed instructions which raised the issue that the property owner was entitled to the highest price obtainable on the open market for the property taken. The generally accepted measure of damage is the fair market value. Fair market value is defined to be the price that a willing seller not compelled to sell would require from a willing buyer not compelled to buy. The definition also contemplates a well informed seller. It is obvious that a well informed seller would take nothing but the highest price



obtainable on the open market. The tendency of condemnation actions is for a jury to compromise or average the values reflected by the various comparable sales. This should not be done. To avoid such averaging or compromising, instructions such as appellant's proposed instructions 4, 12, 13 and 14 should have been given (I R. 68 et seq.).

The trial court failed to submit to the jury the issue whether or not the property owner was entitled to compensation for loss of adequate ingress to or egress from such property as business property. R.C.W. 47.52.080 provides that, in cases involving existing highways, if the abutting property is used for business, the owner is entitled to compensate for loss of adequate ingress to or egress from such property as business property. This was a vested property right owned by the appellant. As the court failed to submit this question to the jury by refusing to give appellant's proposed instruction No. 20 appellant was deprived of property rights without compensation in violation of the state law, the State Constitution, and the Constitution of the United States of America (I R. 84).

## APPELLANT'S ARGUMENT

### I

Appellant's proposed instruction No. 6 reads as follows (I R. 70) :

"I instruct you that while you may not consider U. S. Highway 82 as contributing to the value of this property you may, however, consider the con-

tribution to value made by State Highway 11A, the Lenox Avenue Overpass and other developments aside from U. S. Highway 82 in arriving at your evaluation of the expert's testimony and in arriving at the award in this case."

State Highway 11A intersects United States Highway 82. At that intersection is located appellant's property, and a portion of appellant's property was taken in connection with the approaches to said Interstate Highway 82 and the construction of Interstate Highway 82 itself. In addition to the approaches and the actual take for construction purposes, the entire access between appellant's property and State Highway 11A was taken as is shown by the maps and the record (Ex. 2). A substitute access was given appellant, not onto State Highway 11A, but on the approach road to Interstate Highway 82. *His entire direct access to State Highway 11A was destroyed and taken by these proceedings* (Ex. 2). Prior to the take, appellant operated a vegetable stand on his premises, and also a vegetable garden for the purpose of supplying the vegetable stand. The general public had direct access from 11A at all points to appellant's property and he conducted a substantial business upon said premises and made his livelihood thereon. After the take the business character of the property was destroyed and appellant no longer was able to maintain his business (II R. 181 et seq.). The business character of the property had great potential. The state Highway 11A served Yakima as its western terminus traveling east through Moxee, across

the Columbia River to the Columbia Basin, connecting with Lolo Pass in Idaho. State Highway 11A served the northern reaches of the Hanford area. Great numbers of workers working at Hanford living in Yakima traverse State Highway 11A daily (II R. 36 et seq.). State Highway 11A also served Sportsman's Park and the Moxee industrial area where several factories had located. Appellant's property therefore had great commercial potential which was entirely destroyed by the take in question. The trial court should have submitted to the jury the above proposed instruction No. 6 which submitted these issues to the jury. Authority for the submission of such issues is found in *Winn v. U.S.*, 272 F. (2d) 282, and *Scottle & Montana Railroad Company v. Roeder*, 30 Wash. 244, 111 Pac. 206. In the first of these cases the court said:

"Lastly, appellants phrase their claim in terms of 'loss of access,' citing *Hughes v. State*, 80 Idaho 286, 328 P. (2d) 397; *State ex rel. Rich v. Dunlick, Inc.*, 77 Idaho 45, 286 P. 2d 1112. An examination of these cases shows that in each an existing access to an existing road was damaged or destroyed by the new construction. Such is not the case in the instant action. The appellants will have the same access to Highway 30 after the Interstate is constructed as they had before.

"The government does not contend that destruction of existing access is not compensable, *Cravens v. United States*, D.C.W.D. Ark. 1958, 163 F. Supp. 309; *Schiefelbein v. United States*, 8 Cir., 1942, 124 F. 2d. 945; but submits that none of appellants' access rights have been destroyed."

and in the second of these cases the court said:

"This land has a special value as stone-producing land. The owners, therefore, are entitled to compensation according to its value as such. *Sanitary District v. Loughran*, *supra*. It is like lands with buildings thereon, or timber land, or lands having any other commodity which is a part of the land itself. \* \* \* If the extent and quality and value of the stone as it lies on the land may not be considered, there would be no way by which the value of the land with the stone could be shown. All legitimate evidence tending to establish the value of the land with the mineral in it is permissible."

Cf. *U.S. v. First National Bank*, 250 F. 299.

Two Washington cases including one which went to the Supreme Court of the United States bear upon this question. In *Ham, et al, v. Northern Pacific Railway Company*, 181 P. 898, 107 Wash. 378, it is said on P. 386 and again on P. 389:

"So it is proper to show that property possesses a peculiar value for railroad purposes, for dock purposes, for a mill site, for a ferry, for market gardening, for raising cranberries, for warehouse purposes, or for a bridge site."

"The case was analyzed and it was pointed out that the owner of the land there involved, which abutted on the river and shore, had no proprietary right in any boom site, and hence was not entitled to have its value for a boom site considered in estimating the value of the land. That the court does not intend, by its decision, to hold that the owner of land which was available for the purpose for which it was sought to be condemned was not entitled to have its value for that purpose considered as an element to establish the market value, is made clear by a later decision wherein an instruction to the jury was sustained to the effect that the jury, in making up their verdict, should take into consideration the value of the land as a boom site, although it was being condemned to be used for that purpose; citing



*Columbia & Cowlitz River Boom & Rafting Co. v. Hutchinson*, 56 Wash. 323, 105 Pac. 636. The distinction between the cases as here made was pointed out by the editor in the foregoing note. It is true that the owner is not permitted to take advantage of the necessities of the condemning party, but neither can the condemner obtain something of value for nothing."

In *Chelan Electric Company v. Perry*, 268 P. 1040, 148 Wash. 353, 49 S. Ct. 478, 279 U.S. 823, 73 L. Ed. 977, the Court said, P. 358:

"While the owner is forced to sell, he is not to receive by reason of that fact a lesser amount than the property would fairly bring upon the market. Likewise the condemnor, although perhaps forced to buy because of the peculiar location of the property with reference to its needs, is not required to pay more because of that fact. The necessities of neither must be permitted to affect the value to be received or paid. *Grays Harbor Boom Co. v. Lownsdale*, 54 Wash. 83, 102 Pac. 1041, 104 Pac. 267; *Ham, Yearsley & Ryrie v. Northern Pac. R. Co.*, 107 Wash. 378, 181 Pac. 898."

The law then becomes clear that the owner is not entitled to an enhancement of value by virtue of the project which makes necessary of the acquisition, but all other uses and relevant factors may be considered by the jury. Thus it was error not to submit instruction No. 6 proposed by appellant.

## II

### FAIR MARKET VALUE

While the trial court submitted the general proposition that the appellant was entitled to recover the fair market value of the property taken, together with a

separate damage to the remainder of the property, the court should have submitted the question more specifically as proposed by appellant's proposed instructions 4, 12, 13, and 14, which read as follows:

"Instruction No. 4

"You are instructed that by fair market value is meant the highest amount of money which in fair and unhurried negotiations, a well-informed purchaser, willing but not obliged to buy the property, would pay to a well-informed seller, willing but not obliged to sell it, taking into consideration all uses, including its highest and best use, to which the property is adapted and might in reason be applied. It means neither a panic price, speculative value nor a value fixed by depressed or inflated prices. Neither is it the value put on the property by the owner because of any value peculiar to him alone, nor because he may be unwilling to sell it, nor is it limited to what the property will bring at a forced sale." (I R. 68)

"Instruction No. 12

"I instruct you the fair market value of a property means not the low or the average, but the best price obtainable on the open market by a willing seller, not compelled, nor hurried, from a willing buyer, not compelled, nor hurried, to buy." (I R. 76)

"Instruction No. 13

"I instruct you that fair market value means the highest price obtainable on the free and open market within a reasonable time. It does not mean the price obtained at the fastest sale or the quickest sale; it can include what might be bought on contract or terms." (I R. 77)

"Instruction No. 14

"I instruct you that fair cash market value means the highest price that a willing and informed buyer not compelled to buy would pay to a willing and in-



formed seller not compelled to sell, each being fully informed as to its past uses, its present condition, and its potential future uses. It means the best price obtainable on the *open market*, not the average and certainly not the lowest, by a seller, well-informed, not compelled to sell, from a buyer also well-informed, not compelled to buy." (I R. 78)

Fair market value, of course, contemplates a well informed buyer and well informed seller. It envisages the price which such a seller will require when he is willing to sell, but not compelled to sell, to a buyer who is not compelled to buy but is also willing to buy. These concepts are basic, but it should be borne in mind that no well informed seller is going to part with his property, even though he is willing to sell, for any price other than the best price on the open market. The well informed buyer knows different, and if he is willing to buy he is willing to pay the price. Actually we have been unable to find any authority to the contrary. The authority in support of this is found in *Sacramento Southern Railway Co. v. Heilbron*, 104 Pac. 979, 156 Cal. 408. In 29 C.J.S., Sec. 137, page 574, it is said:

"The market value of property injured or taken for public use is the *highest price* estimated in terms of money which it would bring if exposed for sale in the open market with a reasonable time allowed in which to find a purchaser."

In the *Sanitary District v. Baumbach*, 270 Ill. 128, 110 N.E. 331, it is stated:

"Highest fair cash market value of their land for the best use to which it was adapted."

In *Little Rock Junction Railway v. Woodruff*, 49 Ark. 381, 5 S.W. 792; 1 Orgel 90:

“It is the highest price which those having the ability \* \* \* are willing to pay.”

To the same effect *Viliborgli v. School District*, 55 Ariz. 230, 100 P. (2d) 178. In *People v. Riciardi*, 23 Cal. (2d) 390, 144 P. (2d) 799, it is stated:

“The highest price estimated in terms of money which the land would bring if exposed for sale on the open market with reasonable time allowed in which to find a purchaser buying with full knowledge of all of its uses and purposes for which it was capable.”

And in 1 Orgel, page 95:

“Best possible price.”

As a matter of fact, the very concept of a seller being one not compelled to sell, but being willing but also being completely informed, stipulating these conditions which are well recognized in the law of valuation, the price could never be less than the best since the seller under such circumstances would never take less than that. The instructions proposed set forth above should have been given.

### III

#### OWNER'S EXISTING ACCESS RIGHTS

As stated above, the northerly boundary of appellant's property prior to the take here involved abutted State Highway 11A (Exs. 1 & 2). This highway is one of the most heavily traveled highways through Yakima with prospects for dramatic increases in traffic count due to the expansion at Hanford, the development of the Columbia Basin, the construction of a new bridge

across the Columbia River, and the extension of the highway across the railroad tracks thereby serving the population in the west side of the city (II R. 36 et seq.; 77; 84 et seq.; 183). The appellant had used the property for commercial purposes, namely a successful vegetable and fruit stand operation (II R. 181). The public had access to the stand from every point along the highway along the northerly boundary of appellant's property before the take (Exs. 1 & 2). To assist the state in establishing Highway 11A as limited access the entire access as it formerly existed was condemned and taken away from the appellant and from the public which was served by the appellant's fruit stand (II R. 10). Instead the appellant was given the access described in the maps, namely to an approach road approaching Interstate Highway No. 82, thus effectively destroying the property as commercial property (Exs. 1 & 2).

The court failed to give appellant's proposed instruction No. 20, which reads as follows:

"I instruct you, ladies and gentlemen of the jury, that the Legislature of the State of Washington has enacted a law for the purpose of protecting an abutter's right of access and providing for compensation for the taking thereof. This statute reads in part as follows:

" 'No existing public highway \* \* \* shall be constructed as a limited access facility except upon the \* \* \* condemnation of the abutting owner's right of access thereto \* \* \*. In cases involving existing highways, if the abutting property is used for business at the time the notice is given as provided in RCW

47.52.072 [which in this case was on or shortly after June 30, 1962] the owner of such property shall be entitled to compensation for the loss of adequate ingress to or egress from such property as business \* \* \*.'” (I R. 84)

The above instruction is based upon RCW 47.52.080, which reads as follows:

“No existing public highway, road or street shall be constructed as a limited access facility except upon the waiver, purchase, or condemnation of the abutting owner’s right of access thereto as herein provided. In cases involving existing highways, if the abutting property is used for business at the time the notice is given as provided in RCW 47.52.072, the owner of such property shall be entitled to compensation for the loss of adequate ingress to or egress from such property as business property in its existing condition at the time of the notice provided in RCW 47.52.072 as for the taking or damaging of property for public use.”

It is obvious that this statute creates a real property right which is vested in the owners of the property. This right has been taken in this condemnation proceeding, and it is a right which he is clearly entitled to become compensated for. The failure to give this instruction in effect constitutes the taking of property rights without compensation in violation of both the statute and the state Constitution and the Federal Constitution. It also works a discrimination between appellant and his neighbors whose property was taken in State Court (II R. 15). There are two cases from this court, *Winn v. United States*, 272 F. (2d) 282, and *Lockwood v. Portland*, 988 Fed. 480, bearing on the issues here. In both of these cases it is submitted the

court recognizes that vested property rights cannot be taken, although in each of these cases the court applied the Federal rule on limitation of owner's access. Whether we view what happened here as a non-jurisdictional *ultra vires* take by the Federal government for non-Federal purposes, (a taking to make State Highway 11A limited access) or we view it as taking of vested property rights without compensation, in either case, the appellant is entitled to a new trial with these issues submitted.

Basically here we are dealing with the nature and extent of the real property interests of the appellant which are taken in these proceedings. These real property interests—which have been taken here—are the interests for which compensation is awarded. See *Duckett vs. U.S.*, 266 U.S. 149, 69 L. Ed. 216, 45 S. Ct. 38 where the Supreme Court stated that by eminent domain the government takes “all interests.” The court states that the accurate view would seem to be that the exercise of the power of eminent domain “extinguishes all previous rights.” See *Polsun Log and Coal v. U.S.*, 160 F. (2d) 712. Compare also *Phyllis v. U.S.*, 243 F. (2d) 1.

To the same effect see *Brownlow v. O'Donoghue Bros.* 276 Fed. 636; *Bartholomae v. U.S.*, 253 F. (2d) 713, 73 ALR (2d) 1293; *U.S. v. Grizzard*, 219 U. S. 180, 55 L. Ed. 165, 31 S. Ct. 162; *Donovan v. Penn Co.*, 199 U. S. 279, 50 L. Ed. 192, 26 S. Ct. 91. A case spe-



cifically in point holding that the state law is the measure of the rights and interests taken for which compensation must be paid is *Schiefelbein v. U.S.*, 124 F. (2d) 945 where the 8th Circuit stated, page 947:

“The theory presented in these and other Iowa cases is that an owner of land has a private property right in a public highway if the only access to his land is over that highway. The vacation of the highway is a taking of his property for which he is entitled to compensation. The property taken and for which compensation is payable is not the land to which access is cut off but the private property of the condemnee in the public highway. That that is also the reason underlying *Union Electric Light Co. v. Snyder Estate Co.* is clear from the only case cited by this court in support of its conclusion. That case is *United States v. Welch*, 217 U.S. 333, 30 S. Ct. 527, 54 L. Ed. 787, 28 L.R.A., N.S., 385, 19 Ann. Cas. 680. The case dealt with a private right-of-way and it supports *Union Electric Light Co. v. Snyder Estate Co.* only upon the theory that the public road involved in the *Union Electric Light Co.* case included property of the nature of a private right-of-way. It was made clear in *United States v. Welch* that the property for which compensation is payable is that actually taken, i.e., the right-of-way, and not that served by the right-of-way, although, said the Supreme Court, ‘the value of the easement cannot be ascertained without reference to the dominant estate to which it was attached.’ ”

It is evident from the foregoing cases that when the United States undertakes a condemnation proceeding in a case such as this, it acquires the fee which is no less than all of the interest and rights possessed and vested in the condemnee, including as in this case, the access right at all points along 11A abutting upon appellant's property as measured and described and vest-



ed in the condemnee by the above cited statute, R.C.W. 47.52.080.

### CONCLUSION

It is respectfully submitted that the appellant is entitled to a new trial with the issues properly framed by appropriate instructions.

Respectfully submitted,  
KENNETH C. HAWKINS  
*Attorney for Appellant*

## APPENDIX

## EXHIBITS

	Identified	Received
Exhibit No. 1	6	6
2	11	18
3	26	27
4	30	31
5	42	60
6-A - 6-G . . . . .	77	82
7-A - 7-B . . . . .	77	82
2-A - 2-B . . . . .	83	84
8 . . . . .	108	110

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

---

Kenneth C. Hawkins  
Attorney for Appellant

**United States Court of Appeals**  
**FOR THE NINTH CIRCUIT**

UNITED STATES OF AMERICA,

Appellant,

v.

JAMES H. MARSHALL and THELMA MARSHALL,

Appellees.

ON APPEAL FROM THE JUDGMENT OF  
THE UNITED STATES DISTRICT COURT FOR  
THE SOUTHERN DISTRICT OF CALIFORNIA  
SOUTHERN DIVISION

---

BRIEF FOR THE APPELLEE

---

DRISCOLL, HARMSSEN & WILKINS

By: HARLAN F. HARMSSEN and

JOHN GERALD DRISCOLL, Jr.

830 San Diego Trust & Savings Building  
San Diego, California 92101

Attorneys for Plaintiffs and Appellees

FILED

OCT 16 1960

U.S. DISTRICT COURT  
SOUTHERN DISTRICT OF CALIFORNIA



## SUBJECT INDEX

	Page
<u>OPINION OF DISTRICT COURT</u> . . . . .	1
<u>JURISDICTION.</u> . . . . .	1
<u>QUESTION INVOLVED.</u> . . . . .	2
<u>STATUTE AND REGULATION INVOLVED</u> . . . . .	2
<u>STATEMENT OF THE CASE</u> . . . . .	5
<u>SUMMARY OF ARGUMENT</u> . . . . .	6
<u>ARGUMENT</u> . . . . .	7
A. BASIS OF THE INSTALLMENT SALE PROVISIONS . . . . .	7
B. THE DISTRICT COURT'S DECISION IS SUPPORTED BY THE "MORTGAGE RULE" . . . . .	8
C. THE DISTRICT COURT'S DECISION IS SUPPORTED BY RULES APPLICABLE TO STOCK PURCHASES . . . . .	11
D. THE DISTRICT COURT'S DECISION IS SUPPORTED BY SIMILAR RULES APPLICABLE TO TAX-FREE EX- CHANGES . . . . .	11
E. THE DISTRICT COURT'S DECISION IS SUPPORTED BY THE RULES APPLICABLE TO CONTRACTS OF SALE . . .	13
F. THE DISTRICT COURT'S DECISION IS SUPPORTED BY THE RULE ESTABLISHED IN THE LIPMAN CASE. . . . .	13
G. THE DOCTRINE OF CONSTRUCTIVE RECEIPT OF IN- COME, RELIED UPON BY APPELLANT, IS INAP- PLICABLE . . . . .	14
H. ANALYSIS OF AUTHORITIES RELIED UPON BY APPELLANT. . . . .	16
<u>CONCLUSION</u> . . . . .	23



# SUBJECT INDEX (Continued)

	Page
<u>APPENDIX A</u> . . . . .	25
Numerical Summary of the Respective positions of the Taxpayers and the Commissioner of Internal Revenue. . . . .	27
<u>CERTIFICATE</u> . . . . .	29

## CITATIONS

### Cases:

Abbey v. Zimmerman, 12 Cal. App. 2d 311 . . . . .	18
Burnet v. S. & L. Building Corporation, 288 U. S. 408 . . . . .	7, 8, 9, 18
Caldwell v. United States, 114 F. 2d 995. . . . .	22
C. I. R. v. South Texas Lumber Company, 333 U. S. 496 . . . .	7
Corona Flushing Co. v. Commissioner, 22 B. T. A. 1344 . . . . .	20, 21
Denco Lumber Co., 39 T. C. 8 . . . . .	8
Diescher v. Commissioner, 36 B. T. A. 732 . . . . .	19
Freeman v. Commissioner, 303 F. 2d 580 . . . . .	22
H. W. Johnston, 14 T. C. 560. . . . .	15
Arthur L. Kniffen, 39 TC 553. . . . .	11, 12
Estate of Henry Lipman, et al., v. U. S. 65-2 U. S. T. C. 9579 (DCED Tenn. July 12, 1965) . . . . .	13
Ludlow v. C. I. R., 36 T. C. 102 . . . . .	17
J. W. McWilliams, 15 B. T. A. 329 . . . . .	13, 16
Mendham Corporation v. Commissioner, 9 T. C. 320. . . . .	19
Rebecca J. Murray, 28 B. T. A. 624 . . . . .	15

# CITATIONS (Continued)

<u>Cases: (Continued)</u>	Page
R. O'Dell & Sons Co. v. Commissioner, 169 F.2d 247 . . . . .	19
Pedro Sanchez, 6 T.C. 1141 . . . . .	15
Smith v. Commissioner, 324 Fed.2d 725 . . . . .	18
Sowell v. Commissioner, 302 F.2d 177 . . . . .	19
N. F. Tester, 327 F.2d 788. . . . .	11
Tombari v. Commissioner, 299 F.2d 889. . . . .	20
United Pacific Corp., 39 T.C. 721 . . . . .	8
Wagegro Corp. v. Commissioner, 38 B.T.A. 1225 . . . . .	21
Katherine H. Watson, 20 B.T.A. 270 . . . . .	8, 16, 20

## Statutes:

### Internal Revenue Code of 1954:

Section 351 . . . . .	6, 11, 12, 23
Section 357 . . . . .	6, 11, 12, 23
Section 451 . . . . .	14
Section 453 . . . . .	2, 6, 7, 14, 23
Section 1001(b). . . . .	18
28 U.S.C. 1291 . . . . .	2
28 U.S.C. 1340 . . . . .	1
28 U.S.C. 1346 (a) (1). . . . .	1

# CITATIONS (Continued)

	Page
<u>Miscellaneous:</u>	
Treasury Regulations on Income Tax (1954 Code)	
Section 1.451-2 . . . . .	14, 15
Section 1.453-4 . . . . .	4, 8
I. T. 2468 VIII-1 C. B. 159 (1929) . . . . .	11
Revenue Ruling 60-52, 1960-1 C. B. 186. . . . .	16
California Civil Code Section 3440.1, now California Commercial Code Section 6101, et seq. . . . .	17
23 Cal. Jur. 2d 527 . . . . .	17

IN THE  
UNITED STATES COURT OF APPEALS  
FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA,

Appellant,

v.

JAMES H. MARSHALL and THELMA MARSHALL,

Appellees.

ON APPEAL FROM THE JUDGMENT OF  
THE UNITED STATES DISTRICT COURT FOR  
THE SOUTHERN DISTRICT OF CALIFORNIA  
SOUTHERN DIVISION

---

BRIEF FOR THE APPELLEES

---

OPINION OF THE DISTRICT COURT

The opinion of the District Court (R. 43-47) by James M. Carter, Judge,

is reported at 241 F. Supp. 30.

JURISDICTION

On July 19, 1963, James H. Marshall and Thelma Marshall filed a complaint in the U. S. District Court for the Southern District of California, seeking refund of a portion of the federal income tax paid for 1959. The District Court had jurisdiction pursuant to 28 U. S. C., Sections 1340 and 1346(a)(1). The case was submitted on pre-trial stipulation of facts (R. 10-13) and written briefs (R. 14-42).

The taxpayers prevailed in a memorandum decision filed September 30, 1964 (R. 43-47). Judgment (R. 53) and findings of fact and conclusions of law (R. 48-52) were filed on January 26, 1965. Notice of appeal was filed by the United States on March 29, 1965 (R. 55). This court has jurisdiction to review the decision of the District Court pursuant to 28 U. S. C. , Section 1291.

### QUESTION INVOLVED

Whether the District Court erred in holding that the taxpayers properly treated the sale of their business as an installment sale, for the reason that the buyer's assumption and payment of current liabilities of the business did not constitute initial payment in the year of sale under Section 453 (b) (2) (A) (ii) of the Internal Revenue Code of 1954.

### STATUTE AND REGULATION INVOLVED

Internal Revenue Code of 1954:

#### SEC. 453. INSTALLMENT METHOD.

(a) Dealers in Personal Property. -- Under regulations prescribed by the Secretary or his delegate, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the gross profit, realized or to be realized when payment is completed, bears to the total contract price.

(b) Sales of Realty and Casual Sales of Personalty. --

(1) General rule. -- Income from --

- (A) a sale or other disposition of real property, or
- (B) a casual sale or other casual disposition of personal property (other than property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year) for a price exceeding \$1,000,

may (under regulations prescribed by the Secretary or his delegate) be returned on the basis and in the manner prescribed in subsection (a).

(2) Limitation. -- Paragraph (1) shall apply --

- (A) In the case of a sale or other disposition during a taxable year beginning after December 31, 1953 (whether or not such taxable year ends after the date of enactment of this title), only if in the taxable year of the sale or other disposition --
  - (i) there are no payments, or
  - (ii) the payments (exclusive of evidences of indebtedness of the purchaser) do not exceed 30 percent of the selling price.
- (B) In the case of a sale or other disposition during a taxable year beginning before January 1, 1954, only if the income was (by reason of section 44(b) of the Internal Revenue Code of 1939) returnable on the basis and in the manner prescribed in Section 44(a)



of such code.

Treasury Regulations on Income Tax (1954 Code):

Sec. 1.453-4 Sale of real property involving deferred periodic payments.

(a) In general. Sales of real property involving deferred payments include (1) agreements of purchase and sale which contemplate that a conveyance is not to be made at the outset, but only after all or a substantial portion of the selling price has been paid, and (2) sales in which there is an immediate transfer of title, the vendor being protected by a mortgage or other lien as to deferred payments.

(b) Classes of sales. Such sales, under either paragraph (a) (1) or (2) of this section, fall into two classes when considered with respect to the terms of sale, as follows:

(1) Sales of real property which may be accounted for on the installment method, that is, sales of real property in which (i) there are no payments during the taxable year of the sale or (ii) the payments in such taxable year (exclusive of evidences of indebtedness of the purchaser) do not exceed 30 percent of the selling price, or

(2) Deferred-payment sales of real property in which the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable year in which the sale is made exceed 30 percent of the selling price.

(c) Determination of "selling price". In the sale of mortgaged property the amount of the mortgage, whether the property is merely taken subject to the mortgage or whether the mortgage is assumed by the purchaser, shall, for the purpose of determining whether a sale is on the installment plan, be included as a part of the "selling price"; and for the purpose of determining the payments and the total contract price as those terms are used in section 453, and sections 1.453-1 through 1.453-7, the amount of such mortgage shall be included only to the extent that it exceeds the basis of the property. The term "payments" does not include amounts received by the vendor in the year of sale from the disposition to a third person of notes given by the vendee as part of the purchase price which are due and payable in subsequent years. Commissions and other selling expenses paid or incurred by the vendor shall not reduce the amount of the payments, the total contract price, or the selling price.

(26 C. F. R. , Sec. 1.453-4.)

#### STATEMENT OF THE CASE

The appellant's statement of the case is not controverted. In 1959, plaintiffs sold the business and assets of their company to a corporation in which they were shareholders with two other persons. The sale was reported as an installment sale. The company's current liabilities were assumed and paid by the corporation in 1959 in the ordinary course of business. The Commissioner refused

to treat the sale as an installment sale on the grounds that the payments in the year of sale exceeded 30% of the selling price. A numerical summary of the respective positions of the taxpayers and the Commissioner of Internal Revenue is contained in Appendix A.

### SUMMARY OF ARGUMENT

The assumption and payment of current liabilities by the buyer in the year of sale are not initial payments under Section 453(b) (2) (A) (ii). The undisputed gain of \$20,287.39 will be and should be reported over the years as installments are received on the contract price of \$84,944.36 to be paid by the buyer to seller. The appellees' position is consistent with the statute and regulations and is supported by (1) the underlying basis and reason for the installment sale provisions, (2) the rule applicable to secured liabilities set forth in the regulations as approved by the Supreme Court, (3) the rule in similar situations concerning the assumption of liabilities where stock is sold or real property is sold on a contract of sale, and (4) the analogous situation involving the assumption of liabilities under Sections 351 and 357 of the Internal Revenue Code. The appellant's reliance on the constructive receipt doctrine is not applicable or supported by the authorities cited. If the appellant's position is accepted, a distinction without merit, contrary to the purpose and plain meaning of the statute would result. The assumption of the seller's liabilities owing to third parties by the buyer should not constitute initial payment regardless of whether the liabilities are (1) paid in full or in part in the year of sale, (2) long-term or short-term, (3) secured or unsecured, or (4) pertain to real or personal property. The adoption of appellant's position would permit a variety of rules depending on a variety of factors that have no logic or

reason in determining the applicability of the installment sale provisions, and would cause unfair, inequitable and unintended results.

## ARGUMENT

### A. BASIS OF THE INSTALLMENT SALE PROVISIONS.

Section 453(b) of the Internal Revenue Code of 1954 provides for the installment method of reporting income from the casual sale of realty and personal property if the payments (exclusive of evidences of indebtedness of the purchaser) received during the taxable year of sale do not exceed thirty percent (30%) of the selling price. The District Court's decision upon a question heretofore undecided, in the construction of the above statute finds ample support in the basic reason for the installment sale provisions and the application of such provisions to analogous questions.

The installment sales provisions were enacted to relieve taxpayers who received only a small portion of the sale price in cash from paying full tax on the gain in the year of sale, thus allowing the gain to be spread over the period during which the taxpayer would receive the funds.<sup>(1)</sup> Burnet v. S. & L. Building Corporation, 288 U.S. 406 (1933); C.I.R. v. South Texas Lumber Company, 333 U.S. 496 (1948).

---

1. "The installment basis of reporting was enacted, as shown by its history, to relieve taxpayers who adopted it from having to pay an income tax in the year of sale based on the full amount of anticipated profits when in fact they had received in cash only a small portion of the sales price."

Commissioner v. South Texas Lumber Company, 333 U.S. 496, 503 (1948).



B. THE DISTRICT COURT'S DECISION IS SUPPORTED BY THE "MORTGAGE RULE"

In sales of mortgaged property, the amount of the mortgage is included in the "selling price" but in determining the "contract price" and payments in the year of sale, the amount of the mortgage is treated as "payment" only to the extent that it exceeds the basis of the property sold. (2) This insures that the entire profit is reported over the years. United Pacific Corp., 39 T.C. 721, n. 3 (1963). In Denco Lumber Co., 39 T.C. 8 (1962) Acq. 1963-28, 7, a first mortgage in favor of a third party lender which was assumed by the buyer was held not to be initial payment in the year of sale, despite the fact that the mortgage was placed upon the property immediately prior to sale, and the loan proceeds were received by the buyer. The mortgage rule applies with equal logic and purpose to current liabilities, whether such current liabilities are secured or unsecured. There is no real distinction between mortgages and other liabilities assumed by the purchaser; they all represent debts to third parties. Katherine H. Watson, 20 B.T.A. 270 (1930),

---

2. U.S. Treasury Regulations, Sec. 1.453-4(c)

". . .

(c) Determination of 'selling price'. In the sale of mortgaged property the amount of the mortgage, whether the property is merely taken subject to the mortgage or whether the mortgage is assumed by the purchaser, shall, for the purpose of determining whether a sale is on the installment plan, be included as a part of the 'selling price'; and for the purpose of determining the payments and the total contract price as those terms are used in section 453, and Sections 1.453-1 through 1.453-7, the amount of such mortgage shall be included only to the extent that it exceeds the basis of the property. The term 'payments' does not include amounts received by the vendor in the year of sale from the disposition to a third person of notes given by the vendee as part of the purchase price which are due and payable in subsequent years. Commissions and other selling expenses paid or incurred by the vendor shall not reduce the amount of the payments, the total contract price, or the selling price. (Reg. Sec. 1.453-4.)"

Acq. X-1, C. B. 68 (1931).

The Supreme Court in Burnet, supra, recognized the practical difficulties inherent if mortgages were not excluded from the sale price in determining the contract price.<sup>(3)</sup> The same practical difficulties will be compounded because of the number of third-party creditors with different payment terms if current liabilities to such third persons are likewise not excluded in determining the contract price. Appellant's position as to current liabilities is precisely that which the Supreme Court rejected as to mortgages in Burnet. In arriving at that holding, the Supreme Court recognized the necessity of reporting the entire gain in an orderly manner as the taxpayer received the money over the years. To tax the entire gain in the year of sale when the taxpayer has little or no cash to pay the tax would work an inequity and foster administrative difficulties.

Though acknowledging the mortgage rule (Brief of Appellant, p. 19.), appellant inconsistently contends that the year in which the liabilities are actually paid is determinative. If appellant's contention is accepted, the applicability of the installment sale provisions would depend upon circumstances over which the seller-taxpayer has no control, namely, the time such liabilities are in fact paid by the buyer. Further, such seller would be burdened with ascertaining when such liabilities were paid from his buyer's records. Numerous payments on many different dates and during varying periods of time are likely to be involved. In the instant case, which involves numerous unsecured liabilities, it is impossible to determine

3. "The method suggested by the respondent would inevitably lead to many practical difficulties; might postpone collection far beyond the time when the vendor would receive any direct payments; and probably would render impossible determination from the taxpayer's books of what he should account for." Burnet v. S. & L. Building Corporation, 288 U.S. 406, 414 (1933).



from the taxpayer's books and records when such liabilities were paid by the buyer and the taxpayer may not be able to secure this information from the buyer.

The time that the buyer makes payment of the liabilities to third parties logically has no bearing on whether a taxpayer is entitled to use the installment sale method. If, for example, the transaction takes place on December 15 and the current liabilities are paid the following year or years, the taxpayer would be entitled to use the installment method. To deny use of such installment method in the instant case is to draw a distinction without a difference. If the appellant's argument is accepted, there would remain the question of transactions involving partial payment by the buyer in the year of sale of such liabilities. The question would then arise as to whether payment in subsequent years of these liabilities would be considered payments to the seller. If the appellant's argument that the payments in the year of sale on such liabilities are constructively received is valid, then it must follow that payments on such liabilities by the buyer in following years would be constructively received in those years. Appellant has not faced these questions. Under the mortgage rule, it makes no difference when the mortgage is actually paid, and a taxpayer is entitled to use the installment method even though the entire mortgage may be both payable and paid by the purchaser immediately after the sale. The regulations and authorities logically make no inquiry into the date a mortgage is payable or paid. Significantly, there are no statutes, no regulations and no decisions expressly precluding application of the well-established mortgage rule to current liabilities.

C. THE DISTRICT COURT'S DECISION IS SUPPORTED BY RULES APPLICABLE TO STOCK PURCHASES.

Where a purchaser of stock assumes the seller's unpaid balance owing on the shares, this assumption of liability is not treated as initial payment. I. T. 2468 VIII-1 C. B. 159 (1929). The ruling holds that the assumption by the purchaser of the unpaid balance due from the taxpayer is considered to be the same as that of the assumption of an existing mortgage in connection with a sale of property.

D. THE DISTRICT COURT'S DECISION IS SUPPORTED BY SIMILAR RULES APPLICABLE TO TAX-FREE EXCHANGES.

Tax-free exchanges under Section 351 of the Internal Revenue Code become taxable under Section 357 to the extent the liabilities exceed basis and no distinction is made depending on whether or not the liability is in the form of a mortgage. See N. F. Tester, 40 T. C. 273 (1963), Affd. 327 F.2d 788 (7th Cir. 1964) where only open accounts payable are involved in a transfer of a going business to a controlled corporation and the Court treated them the same as secured liabilities under Section 357.

In Arthur L. Kniffen, 39 T. C. 553 (1962), the taxpayer transferred the assets and liabilities of his sole proprietorship to a corporation in exchange for 1,000 shares of stock. After the exchange, the taxpayer held 1,048 out of the 1,050 shares issued and outstanding. The corporation assumed liabilities of approximately \$294,000 which exceeded the basis of the assets transferred of approximately \$286,000. Included in the liabilities of the taxpayer was an account payable in the amount of approximately \$44,000 in favor of the corporation which was assumed and

discharged in the transaction. The issue was whether the \$44,000 in accounts payable assumed and discharged in the transaction was "other property or money" under Section 351(b) dealing with tax-free transfers to a controlled corporation. The Commissioner argued that the assumption and discharge was "other property or money", that Sections 351 and 357 would not be applicable and that a substantial gain would therefore result to the taxpayer. The Court held that the assumption and discharge was not "money or other property" for purpose of Sections 351 and 357 and that only the \$8,000 of total liabilities in excess of basis would be realized gain. The questions presented to this Court is analogous. in Kniffen, the Court, holding that it does not matter when the liability is discharged by the transferee and to whom the liability is owed, said:

'As we read sections 351 and 357 of the 1954 Code and section 112 (b) (5) and (k) of the 1939 Code, Congress, in employing the term "liability" in section 357(a) and section 112(k), was looking at the assumption by the transferee corporation of an existing liability of the transferor, not to the subsequent extinguishment of the debt, whether by payment, operation of law, or otherwise.

Normally the liability accounts transferred pursuant to an exchange qualifying under section 351 will later be discharged in due course by the corporate transferee. But the fact of subsequent discharge and the time of discharge appear to be irrelevant in determining the applicability of

that section so long as the liabilities belong to the transferor at the time of the exchange and the purpose of the assumption is other than the avoidance of Federal income tax as described in section 357(b). Conceivably some of the "assumed" liability accounts may be discharged by the acquiring corporation on the same date the exchange was consummated. Others possibly might be defaulted and never discharged. But these facts do not appear to affect the applicability of sections 351 and 357 to an otherwise qualifying exchange.

Nor does it appear to be of critical importance to whom the liability is owed." (p. 561.) (Emphasis the court's.)

**E. THE DISTRICT COURT'S DECISION IS SUPPORTED BY THE RULES APPLICABLE TO CONTRACTS OF SALE.**

When a purchaser assumes a liability to which property is subject in a contract of sale, such assumption is not initial payment. J.W. McWilliams, 15 B. T. A. 329 (1929), Acq. VIII-2, C.B. 34 (1929). A land sale contract, while similar to a mortgage, legally is not a mortgage. Nevertheless, the Court applied the same rules and regulations to the contract as are applied to a mortgage. No payments were made by the purchaser to the third party creditor in the year of sale. Had any such payments been made, the Court would be forced to violate the mortgage rule to hold that such payments were initial payment in the year of sale.

**F. THE DISTRICT COURT'S DECISION IS SUPPORTED BY THE RULE ESTABLISHED IN THE LIPMAN CASE.**

In the Estate of Henry Lipman, et al., v. U.S., 65-2 U.S. T.C. 9579 (DCED Tenn. July 12, 1965) the wife in 1959 sold shares with a cost basis of \$14,400 to a corporation in which her husband was the Treasurer and a Director for \$54,000. The terms of sale provided for payments of \$6,000 per year, starting in 1960, and as



part consideration, the parties agreed that the corporation might retire an \$18,000 debt that her husband owed to the corporation by crediting \$6,000 per year against the indebtedness commencing in 1965. Accordingly, she would receive approximately \$35,000 in cash and the cancellation of her husband's indebtedness in the amount of \$18,000. The Court held that neither Mr. or Mrs. Lipman received any payment in the year of sale, 1959, and accordingly, the installment sale method was permitted.

G. THE DOCTRINE OF CONSTRUCTIVE RECEIPT OF INCOME, RELIED UPON BY APPELLANT, IS INAPPLICABLE.

The appellant argues that the assumption and payment by the buyer in the year sale amounts to a constructive receipt of a payment in the year of sale. Appellant does not contend that the mere assumption without payment thereon in the year of sale should be treated as such a payment.

There is no question that the mere assumption of the liabilities in question is "consideration", part of the "selling price" and considered in computing the "gain" on the transaction. The question is whether or not such assumption and payment is part of the initial payment.

The facts here indicate no agreement as to when the buyer was to pay the liabilities. The facts do not indicate when the liabilities were due, or that the taxpayer had any control over the payment of them by the buyer corporation. There is nothing in the facts to indicate constructive receipt.

Section 451 of the Internal Revenue Code provides that the amount of any item of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under the method of accounting used in computing taxable income, such amount is to be properly accounted for as of a different period. Section 453 provides such a method, the installment sale method. The doctrine of constructive receipt of income is set forth in Regulations Section 1.451-2, which states that income, although not actually reduced to a taxpayer's

is credited to his account or set apart for him so that he may draw upon it at any time. <sup>(4)</sup> No amounts were credited or set aside for the taxpayer in the instant case since the liabilities were payable to third parties. There is nothing in the facts to indicate what persons had the responsibility of paying the bills of the purchaser corporation. Clearly the doctrine of constructive receipt has no application to the case in question.

The Tax Court has frequently stated that the doctrine of constructive receipt is to be "sparingly applied", and that the doctrine would be invoked only in "unique circumstances and a clear case". Pedro Sanchez, 6 T.C. 1141, 1148 (1946) affirmed 162 Fed. 2d 58 (2nd Cir. 1947).

Cash is not constructively received by a seller when it is placed in escrow if the cash is not unqualifiedly subject to the demand of the seller. Harold W. Johnston, 14 T.C. 560 (1950). A seller was entitled to use the installment method where 75% of the sale proceeds were deposited in escrow to be released over a period of five years to the seller. The receipt of these funds by the escrow holder did not constitute constructive receipt. Rebecca J. Murray, 28 B.T.A. 624 (1933).

If appellant's argument of assumption and constructive receipt were consistently applied, it would be equally applicable in the case of a liability secured by a mortgage and such position would then be contrary to the Regulations and authorities

---

4. "Constructive receipt of income. -- (a) General Rule. Income although not actually reduced to a taxpayer's possession is constructively received by him in the taxable year during which it is credited to his account, set apart for him, or otherwise made available so that he may draw upon it at any time, or so that he could have drawn upon it during the taxable year if notice of intention to withdraw had been given. However, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions." U.S. Treasury Regulations, Sec. 1.451-2(a)



cited.

#### H. ANALYSIS OF AUTHORITIES RELIED UPON BY APPELLANT

The appellant argues that McWilliams v. Commissioner, 15 B. T. A. 329 (1929) cited by the District Court, is not authority for its decision. (Brief of Appellant, p. 21.) The court held that the assumption of the contractual liability on the land was similar to a purchase money mortgage and should be treated the same way, and, accordingly, that the purchase price included the \$130,000 unpaid on the contract at the time of sale by the taxpayer. The court did not hold that this \$130,000 was part of the initial payment; had the \$130,000 been considered initial payment, the installment method would not have been available. The quotation from McWilliams in the appellant's brief (p. 22) sets forth the reasoning of the court that the assumption of the land contract should be considered the same as a mortgage.

Revenue Ruling 60-52, 1960-1 CB 186, (Brief of Appellant, p. 27.) is concerned with a similar but narrower problem common in the sale of real property not encountered herein. Such expenses are usually paid at the time of sale and are often paid immediately through escrow. In this connection, the language of the Court in Katherine H. Watson, 20 B. T. A. 270, 272 (1930) should be noted:

"No brief has been filed on behalf of the respondent and we are not informed of his reason for including as a part of the initial payment the amount of the prorated charges assumed by the purchaser in the face of his regulations excluding therefrom the amount of the mortgages. The evidence is clear that the prorated charges were not paid by the purchaser within the

taxable year. From a practical standpoint there is no real distinction between the two forms of indebtedness assumed by the purchaser. All of the items represented debts of the petitioners to third parties, and, like the mortgages assumed were liens against the land sold. The sum of \$24,017.50 being less than 25 per cent of the selling price of the property, petitioners are entitled to return the sale on the installment basis. "

It is clear from the above that the Court felt there was no difference between secured and unsecured liabilities and it is certainly not clear that had such payments been made in the year of sale that they would have been included as initial payment by the court. We submit that the reason for the holding that accrued interest and taxes assumed by the buyer, though includable in the purchase price, were not part of the initial payment is not because there was no evidence that the buyer paid these items in the year of sale but rather that the court wished to treat the unsecured liabilities of the seller in the same manner as the assumption of a mortgage.

A seller has been permitted to return part of the initial payment to the buyer where he received in excess of 30 per cent through a mutual mistake and thereby report the sale on the installment method. Ludlow v. C.I.R., 36 T.C. 102 (1961).

The assets of the business sold by appellees are subject to the liabilities where no notice is recorded and published under the Bulk Sales Law. (California Civil Code, Section 3440.1, now California Commercial Code Sections 6101 et seq.) The purchaser obtains title to the assets subject to the claim of the creditors, 23

Cal. Jur. 2d 527; Abbey v. Zimmerman, 12 Cal. App. 2d 311 (1936).

Appellant relies on Smith v. Commissioner, 324 Fed. 2d 725 (9th Cir. 1964) for the proposition that the "amount realized", "selling price" and "total contract price" include the liabilities of the seller assumed by the purchaser. (Brief of Appellant, p. 15.) The Smith case was not an installment sale case. It involved the question of whether or not a sale took place in 1956 or 1957, and, secondly, if the sale was a 1956 sale whether all of the gain was taxable in 1956, which depended upon the valuation of the sale contract. The taxpayer argued that the sale contract could not be valued and, accordingly, the gain should not be realized in 1956. The Tax Court held that it was not necessary to value the contract and said that the agreement to discharge personal obligations of the seller is the same as receiving cash. The Ninth Circuit properly held that the assumption of these personal obligations may be treated as "money received" under Sec. 1001(b) of the Internal Revenue Code of 1954 for purposes of determining the amount of gain. If one were to take the statement at face value that the agreement to discharge the personal obligations of the seller is tantamount to receiving cash, then this statement would be equally applicable in the case of mortgages or secured obligations, long or short term obligations, and would be clearly contrary to the mortgage rule set forth in the Regulations. In Burnet, supra, the court and the Commissioner held the "total contract price" to be the amount payable directly to the vendor.

All of the cases cited by the Ninth Circuit in Smith, as set forth by appellant (Brief of Appellant, pp. 16-17.) properly hold that the mortgages involved in each case are part of the amount realized and must be taken into consideration

in computing the gain. Appellee has no argument with these cases. None are installment sales cases, and none involve the question of initial payments in the year of sale. If these cases were decided otherwise, gain realized would escape taxation completely.

For example, the R. O'Dell & Sons Co. v. Commissioner, 169 Fed.2d 247 (3rd Cir. 1948) and Mendham Corporation v. Commissioner, 9 T.C. 320 (1947) cases simply hold that the discharge of a mortgage in excess of basis results in taxable gain.

None of the cases cited by the appellant on page 17 of its brief for the proposition that payment of the seller's liability represents constructive receipt are installment sale cases. In fact, only a few of these cases make any reference to "constructive receipt" in the opinions. These cases merely hold, and rightly so, that when another party to a transaction discharges an obligation of a taxpayer that the taxpayer thereby realizes income.

For example, in Sowell v. Commissioner, 302 Fed.2d 177 (5th Cir. 1962) the court held that oil and gas income is constructively received when the income therefrom is applied in payment of debts for which the taxpayer's economic interest is liable. Interestingly enough, the court refers to this as a "man bites dog case" where the taxpayer argued that he had received income; the Commissioner argued that there was no constructive receipt of income. The case properly stands for the principle that application of the taxpayer's own income from his property in discharge of his debts is the realization of income by the taxpayer.

In Diescher v. Commissioner, 36 B.T.A. 732 (1937) the court merely held that a principal realizes taxable income when his agent receives money and does not



remit that income to the principal.

Tombari v. Commissioner, 299 Fed.2d 889 (9th Cir. 1962), (Brief of Appellant, p. 18.) is not in point. The issue was whether or not a contract owned by the buyer and assigned to the seller as part of the purchase price for the sale of a pharmacy should be valued at face value or market value in computing the sale price upon which the 30% payment in the year of sale rule is based. The court held that the face value of the chose in action received by the seller is the proper amount to include in the sale price.

Corona Flushing Co. v. Commissioner, 22 B.T.A. 1344 (1931) (Brief of Appellant, p. 21.) does not hold that assumed liabilities paid in the year of sale by the buyer are payments received in the year of sale. In that case the taxpayer sold real property for a purchase price of \$32,000 made up as follows: \$3,000 cash upon signing of the contract; \$8,960 by assumption of a first mortgage; \$15,000 in the form of a purchase money second mortgage; and \$5,040 in cash on delivery of the deed at the closing of title. The seller was obligated in the transaction to pay \$458.52 for prorated taxes and interest and this amount was paid by the taxpayer to the purchaser on the closing of title. The taxpayer argued that he had not received the \$5,040 at closing but rather the net amount of \$4,581.48. The court held that since he had actually received the \$5,040 it must be considered part of the initial payment. The court said, "If the items, aggregating \$458.52, were in fact assumed by the purchaser there might be some ground for excluding these items from the initial payments, as we did in Katherine H. Watson et al., . . ." 22 B.T.A. 1344, 1346. The court further said: "All of these items, totaling \$458.52, were liabilities which the petitioner had to discharge before it could

convey the property free of encumbrances. " 22 B. T. A. 1344, 1347.

The appellant argues that there would be no difference from a tax standpoint if the purchaser had paid the \$25,568.86 directly to the taxpayers (appellees) and they had used the proceeds to pay the accounts payable. We concede that had the taxpayers actually received \$25,568.86 in cash from the purchaser in the year of sale with no assumption by the buyer that this would be considered initial payment. This did not take place. However, as quoted in Corona Flushing Co. ". . . It seems to us to be fundamentally unsound to determine income tax liability by what might have taken place rather than what actually occurred. Even though the practical effect may be the same in either case, the resulting tax liability may be quite different. United States v. Isham, 17 Wall 496, . . . " 22 B. T. A. 1344, 1347.

The holding in Wagegro Corp., 38 B. T. A. 1225 (1938) (Brief of Appellant, p. 21.) that the payment by the buyer of \$750 of legal fees incurred by the seller's attorney in preparing the necessary papers was part of the consideration and initial payment in the year of sale should not be controlling in this case. In the first place, the liability in question was not a pre-existing obligation of the seller which was assumed by the buyer. Secondly, it was one item that both parties knew had been paid and was not fraught with all of the problems apparent in a holding contrary to that of the District Court in this case. Furthermore, it is interesting to note that the Commissioner argued that the \$750 of legal fees was not a part of the purchase price received in the year of sale. The Court, in holding that the legal fee was part of the initial payment, thereby permitted the taxpayer to use the installment basis under the law in existence at that time, which apparently required some down payment in the year of sale.



Caldwell v. United States, 114 Fed.2d 995 (3rd Cir. 1940) (Brief of Appellant, p. 25.) simply holds that a chose in action owing to the buyer and given to the seller as part of the sale price is other property and therefore part of the initial payment. In that case the buyer caused a third party holding company to pay cash and issue obligations to the seller and the court held that the obligations of the holding company were not obligations of the buyer and therefore could not be considered evidences of indebtedness of the buyer.

Freeman v. Commissioner, 303 F.2d 580 (8th Cir. 1962) cited by the appellant (Brief of Appellant, p. 25.) is also not in point and merely holds that the note of a third party received by the seller is other property and is not an obligation of the purchaser. These cases have nothing whatsoever to do with the assumption by the purchaser of an indebtedness of the seller.

### CONCLUSION

The District Court did not err in deciding that the assumption and payment by the purchaser of the current liabilities of the plaintiffs-sellers' business did not constitute "payments actually received in that year" of sale under section 453 of the Internal Revenue Code of 1954, and that the plaintiffs are entitled to report such sale on the installment method. The District Court's decision is consistent with the statute and regulations, and is supported by: (1) the underlying basis and reason for the installment sale provisions, (2) the rule applicable to secured liabilities set forth in the regulations as approved by the Supreme Court, (3) the rule in similar situations concerning the assumption of liabilities where stock is sold or real property is sold on a contract of sale, and (4) the analogous situation involved in the assumption of liabilities under sections 351 and 357 of the Internal Revenue Code.

Respectfully submitted,

DRISCOLL, HARMSSEN & WILKINS,

By: HARLAN F. HARMSSEN and

/s/ JOHN GERALD DRISCOLL, JR.

Attorneys for Appellees

# THE HISTORY OF THE CITY OF BOSTON

The history of the city of Boston is a subject of great interest and importance. It is a city of many centuries, and its history is full of interesting events. The city was founded in 1630, and has since that time been a center of commerce and industry. It has been the site of many important events, and has played a significant role in the history of the United States. The city is known for its many famous landmarks, including the Freedom Trail, the Boston Common, and the Boston Harbor. The city is also known for its many famous people, including John F. Kennedy, Martin Luther King Jr., and many others. The history of the city is a rich and varied one, and it is a subject that is worth studying and exploring.

THE HISTORY OF THE  
CITY OF BOSTON

## APPENDIX A



## APPENDIX A

NUMERICAL SUMMARY OF THE RESPECTIVE POSITION OF  
THE TAXPAYERS AND THE COMMISSIONER OF INTERNAL  
REVENUE

	<u>Taxpayer</u>	<u>Commissioner of Internal Revenue</u>
<u>Sale Price:</u>		
Corporate installment note	\$ 75,000.00	\$ 75,000.00
Assumption of Marshall note by corporation	9,944.36	9,944.36
Assumption of current liabilities by corporation	<u>25,568.86</u>	<u>25,568.86</u>
Total selling price	110,513.22	110,513.22
 Less Adjusted Basis of Business and Assets Sold	 <u>90,225.83</u>	 <u>90,225.83</u>
 <u>Long-Term Capital Gain</u>	 <u>\$ 20,287.39</u>	 <u>\$ 20,287.39</u>
 <u>Payments Received in Year of Sale, 1959:</u>		
Marshall note paid	\$ 9,944.36	\$ 9,944.36
Cash payment on corporate installment note	4,000.00	4,000.00
Assumption and Payment of Current Liabilities by Corporation	<u>-0-</u>	<u>25,568.86</u>
 <u>Total Payments in Year of Sale - Initial Payment</u>	 <u>\$ 13,944.36</u>	 <u>\$ 39,513.22</u>
 30% of Selling Price of \$110,513.22	 \$ 33,153.97	 \$ 33,153.97
 <u>Contract Price:</u>		
Selling Price	\$110,513.22	\$110,513.22
Less Current Liabilities assumed and paid	<u>25,568.86</u>	<u>-0-</u>
Contract Price	\$ 89,944.36	\$110,513.22



			<u>Taxpayer</u>	<u>Commissioner of Internal Revenue</u>
<u>Profit Percentage:</u>				
Taxpayer	$\frac{20,287.39}{84,944.36}$	=	23.883%	
Commissioner	$\frac{20,287.39}{110,513.22}$	=		18.357%
<u>Gain Taxable in 1959:</u>				
Taxpayer	23.883% of \$13,944.36	or	\$ 3,330.33	
Commissioner	18.357% of 110,513.22	or		\$ 20,287.39

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Dated: October 15, 1965.

/s/ JOHN GERALD DRISCOLL, JR.

Attorney for Appellee



---

IN THE UNITED STATES COURT OF APPEALS  
FOR THE NINTH CIRCUIT

---

UNITED STATES OF AMERICA,

Appellant

v.

JAMES H. MARSHALL and THELMA MARSHALL,

Appellees

---

ON APPEAL FROM THE JUDGMENT OF  
THE UNITED STATES DISTRICT COURT FOR  
THE SOUTHERN DISTRICT OF CALIFORNIA

---

BRIEF FOR THE APPELLANT

---

RICHARD M. ROBERTS,  
Acting Assistant Attorney General.

LEE A. JACKSON,  
I. HENRY KUTZ,  
FRED E. YOUNGMAN,  
Attorneys,  
Department of Justice,  
Washington, D. C. 20530.

Of Counsel:

MANUEL L. REAL,  
United States Attorney.

LOYAL E. KEIR,  
Assistant United States Attorney,  
Chief, Tax Division.

JAMES S. BAY,  
Assistant United States Attorney.

FILED

007-1 1115

FRANK H. SCHMID, CLERK



IN THE UNITED STATES COURT OF APPEALS  
FOR THE NINTH CIRCUIT

---

UNITED STATES OF AMERICA,

Appellant

v.

JAMES H. MARSHALL and THELMA MARSHALL,

Appellees

---

ON APPEAL FROM THE JUDGMENT OF  
THE UNITED STATES DISTRICT COURT FOR  
THE SOUTHERN DISTRICT OF CALIFORNIA

---

BRIEF FOR THE APPELLANT

---

RICHARD M. ROBERTS,  
Acting Assistant Attorney General.

LEE A. JACKSON,  
I. HENRY KUTZ,  
FRED E. YOUNGMAN,  
Attorneys,  
Department of Justice,  
Washington, D. C. 20530.

Of Counsel:

MANUEL L. REAL,  
United States Attorney.

LOYAL E. KEIR,  
Assistant United States Attorney,  
Chief, Tax Division.

JAMES S. BAY,  
Assistant United States Attorney.

---

---





## I N D E X

	<u>Page</u>
Opinion below	1
Jurisdiction	1
Question presented	2
Statute and Regulations involved	2
Statement	5
Specification of errors relied upon	8
Summary of argument	8
Argument:	
In determining whether gain from the sale by the taxpayers of their sole proprietorship business may be reported on the installment basis, the payments received by them in the year of sale, within the meaning of Section 453(b) of the Internal Revenue Code of 1954, included the personal obligations of the taxpayers assumed by the purchaser as a part of the selling price to the extent such obligations were actually paid by the purchaser in the taxable year	10
Conclusion	28
Certificate	29

## CITATIONS

### Cases:

Burnet v. Logan, 283 U.S. 404	11, 15
Burnet v. S. & L. Bldg. Corp., 288 U.S. 406	19, 25, 26, 27
Caldwell v. United States, 114 F.2d 995	25
Cisler v. Commissioner, 39 T.C. 458	19, 23
Commissioner v. Fortee Properties, Inc., 211 F.2d 915, reversing 19 T.C. 99	16, 17



Cases (Continued):

Commissioner v. South Texas Co., 333 U.S. 496	19
Corona Flushing Co. v. Commissioner, 22 B. T. A. 1344	21
Crane v. Commissioner, 331 U.S. 1	16
Denco Lumber Co. v. Commissioner, 39 T. C. 8	22
Diescher v. Commissioner, 36 B. T. A. 732, affirmed on another issue, 110 F.2d 90, certiorari denied, 310 U.S. 650	17
Freeman v. Commissioner, 303 F.2d 580	25
Garrison Bros. State Bank v. Commissioner, 67 F.2d 486	17
Harris, T.K., Co. v. Commissioner, 112 F.2d 76	17
Lucas v. North Texas Co., 281 U.S. 11	11
Marshall v. United States, 241 F.Supp. 30	1
McWilliams v. Commissioner, 15 B. T. A. 329	19, 21, 22
Mendham Corp. v. Commissioner, 9 T. C. 320	16
O'Dell, R., & Sons Co. v. Commissioner, 169 F.2d 247, affirming 8 T. C. 1165	16, 17
Old Colony Tr. Co. v. Commissioner, 279 U.S. 716	17
Parker v. Delaney, 186 F.2d 455	16
Reynolds v. McMurray, 60 F.2d 843	17
Smith v. Commissioner, 324 F.2d 725, affirming decision of May 28, 1962 (P-H Memo T. C., par. 62,128)	15, 17
Sowell v. Commissioner, 302 F.2d 177	17



Cases (Continued):

Sterling v. Ham, 3 F.Supp. 386	18
Tombari v. Commissioner, 299 F.2d 889	18
Tressler v. Commissioner, 228 F.2d 356	17
United States v. Boston & M. R. Co., 279 U.S. 732	17
United States v. Joliet & Chicago R. Co., 315 U.S. 44	17
Wagegro Corp. v. Commissioner, 38 B.T.A. 1225	21
Watson v. Commissioner, 20 B.T.A. 270	20

Statutes:

Internal Revenue Code of 1939:	
Sec. 41 (26 U.S.C. 1952 ed., Sec. 41)	10
Sec. 42 (26 U.S.C. 1952 ed., Sec. 42)	11
Sec. 43 (26 U.S.C. 1952 ed., Sec. 43)	11
Internal Revenue Code of 1954:	
Sec. 441 (26 U.S.C. 1958 ed., Sec. 441)	10
Sec. 446 (26 U.S.C. 1958 ed., Sec. 446)	10
Sec. 451 (26 U.S.C. 1958 ed., Sec. 451)	11
Sec. 453 (26 U.S.C. 1958 ed., Sec. 453)	2, 3, 6, 7, 8, 11-14, 18, 19, 23, 24, 27, 28
Sec. 461 (26 U.S.C. 1958 ed., Sec. 461)	11
Sec. 1001 (26 U.S.C. 1958 ed., Sec. 1001)	14
Revenue Act of 1932, c. 209, 47 Stat. 169, Sec. 44	21
28 U.S.C., Sec. 2411	29

Miscellaneous:

I. T. 2468, VIII-1 Cum. Bull. 159 (1929)	19, 25
2 Mertens, Law of Federal Income Taxation (Rev. ed.): Sec. 15.16	20
Sec. 15.18	20
Rev. Rul. 60-52, 1960-1 Cum. Bull. 186	27
Treasury Regulations 69, Art. 44	19
Treasury Regulations on Income Tax:	
Sec. 1.453-4 (26 C.F.R., Sec. 1.453-4)	4, 18, 19
Sec. 1.453-6 (26 C.F.R., Sec. 1.453-6)	15, 18, 19





IN THE UNITED STATES COURT OF APPEALS  
FOR THE NINTH CIRCUIT

---

No. 20,110

UNITED STATES OF AMERICA,

Appellant

v.

JAMES H. MARSHALL and THELMA MARSHALL,

Appellees

---

ON APPEAL FROM THE JUDGMENT OF  
THE UNITED STATES DISTRICT COURT FOR  
THE SOUTHERN DISTRICT OF CALIFORNIA

---

BRIEF FOR THE APPELLANT

---

OPINION BELOW

The opinion of the District Court (R. 43-47) is reported at  
241 F.Supp. 30.

JURISDICTION

This proceeding involves a suit for refund of federal income taxes for 1959 in the sum of \$4,575.87 brought by James H. Marshall and Thelma Marshall (herein sometimes referred to as the taxpayers) by the filing of a complaint (R. 2-5) in the United States District Court for the Southern District of California on July 19, 1963, alleging the payment of such taxes on December 27, 1962, and the timely filing of a claim for refund thereof on January 16,



1963, with a written waiver of registered mail notification of disallowance (R. 3). The District Court had jurisdiction under 28 U.S.C., Sections 1340 and 1346(a). The case was submitted to the District Court on a pre-trial stipulation of facts (R. 10-13) and written briefs (R. 14-42). The District Court resolved the legal issue in favor of the taxpayers in a memorandum of decision filed September 30, 1964. (R. 43-47.) Its findings of fact and conclusions of law (R. 48-52) and its judgment in favor of the taxpayer (R. 53) were filed January 26, 1965. Notice of appeal (R. 55) was filed by the United States on March 29, 1965. Jurisdiction is vested in this Court by 28 U.S.C., Section 1291.

#### QUESTION PRESENTED

Whether the District Court erred in holding that, for the purpose of determining whether gain realized by the taxpayers from the sale of their sole proprietorship business to a corporation in 1959 may be reported on the installment basis, the payments received by them on the purchase price in the year of sale, within the meaning of Section 453(b) of the Internal Revenue Code of 1954, did not include the personal obligations of the taxpayers assumed by the purchasing corporation as a part of the consideration for the sale and actually paid during the year of sale.

#### STATUTE AND REGULATION INVOLVED

Internal Revenue Code of 1954:

##### SEC. 453. INSTALLMENT METHOD.

(a) Dealers in Personal Property. --Under regulations prescribed by the Secretary or his delegate, a person who regularly sells or otherwise disposes of



personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the gross profit, realized or to be realized when payment is completed, bears to the total contract price.

(b) Sales of Realty and Casual Sales of Personalty.--

(1) General rule. --Income from--

(A) a sale or other disposition of real property, or

(B) a casual sale or other casual disposition of personal property (other than property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year) for a price exceeding \$1,000,

may (under regulations prescribed by the Secretary or his delegate) be returned on the basis and in the manner prescribed in subsection (a).

(2) Limitation. --Paragraph (1) shall apply--

(A) In the case of a sale or other disposition during a taxable year beginning after December 31, 1953 (whether or not such taxable year ends after the date of enactment of this title), only if in the taxable year of the sale or other disposition--

(i) there are no payments, or

(ii) the payments (exclusive of evidences of indebtedness of the purchaser) do not exceed 30 percent of the selling price.

(B) In the case of a sale or other disposition during a taxable year beginning before January 1, 1954, only if the income was (by reason of section 44(b) of the Internal Revenue Code of 1939) returnable on the basis and in the manner prescribed in section 44(a) of such code.

\* \* \* \* \*





Treasury Regulations on Income Tax (1954 Code):

§ 1.453-4      Sale of real property involving deferred periodic payments.

(a)      In general. Sales of real property involving deferred payments include (1) agreements of purchase and sale which contemplate that a conveyance is not to be made at the outset, but only after all or a substantial portion of the selling price has been paid, and (2) sales in which there is an immediate transfer of title, the vendor being protected by a mortgage or other lien as to deferred payments.

(b)      Classes of sales. Such sales, under either paragraph (a) (1) or (2) of this section, fall into two classes when considered with respect to the terms of sale, as follows:

(1)      Sales of real property which may be accounted for on the installment method, that is, sales of real property in which (i) there are no payments during the taxable year of the sale or (ii) the payments in such taxable year (exclusive of evidences of indebtedness of the purchaser) do not exceed 30 percent of the selling price, or

(2)      Deferred-payment sales of real property in which the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable year in which the sale is made exceed 30 percent of the selling price.

(c)      Determination of "selling price". In the sale of mortgaged property the amount of the mortgage, whether the property is merely taken subject to the mortgage or whether the mortgage is assumed by the purchaser, shall, for the purpose of determining whether a sale is on the installment plan, be included as a part of the "selling price"; and for the purpose of determining the payments and the total contract price as those terms are used in section 453, and §§1.453-1 through 1.453-7, the amount of such mortgage shall be included only to the extent that it exceeds the basis of the property. The term "payments" does not include amounts received by the vendor in the year of sale from the disposition to a third person of notes given by the vendee as part of the purchase price which are due and payable in subsequent years. Commissions and other selling expenses paid or incurred by the vendor shall not reduce the amount of the payments, the total contract price, or the selling price.

(26 C. F. R., Sec. 1.453-4.)



## STATEMENT

The facts found by the District Court (R. 48-51) are not in dispute. The taxpayers, as sole proprietors, had been engaged in the business of selling agricultural seeds, fertilizers and supplies since 1920 in El Centro, California. They discussed with their accountants and attorneys the advisability of forming a corporation in order to bring a key employee and a third party into the organization. A corporation (Marshall Seed and Feed Company, a California corporation) was formed with an initial capital of \$15,000 cash, of which \$9,000 was contributed by the taxpayers, \$3,000 by R. L. Wilson, and \$3,000 by J. T. Tippet. (R. 49.)

The fixed assets of the taxpayers' business, including good will, were valued at \$37,962.67. The taxpayers agreed to sell and transfer the current assets, fixed assets and good will of the business, of a total agreed value of \$110,513.22, to the corporation in exchange for the corporation's assuming the current liabilities in the amount of \$25,568.86, an account payable from the corporation to the taxpayers of \$9,944.36, <sup>1/</sup> and a promissory note from the

---

1/ The statement in the pre-trial stipulation (R. 11) and in the District Court's findings (R. 49) referring to the \$9,944.36 item as an account payable "from the corporation" to the taxpayers could be confusing because if it represented an obligation of the corporation, other than one assumed as a part of the purchase price of the business, it would not constitute a part of the payment received on the sale of the business. However, the statement of assets and liabilities referred to in the pre-trial stipulation (R. 12) as the document to be offered at the trial as Exhibit C (but not included in the reproduced record) lists this item, designated as "Accounts Payable--James H. Marshall" as one of the liabilities of the business assumed by the corporation in addition to the \$25,568.86 current liabilities also assumed.



corporation for the balance of the purchase price in the amount of \$75,000, payable at the rate of \$500 per month, plus interest at 6 1/2% per annum. The sale was consummated April 1, 1959. No attempt was made to comply with the provisions of the California Bulk Sales Law contained in Section 3440.1 of the California Civil Code. (R. 49.)

The sale price for all of the assets sold was \$110,513.22; the adjusted basis of the assets sold was \$90,225.82; and the long-term capital gain resulting from the sale was \$20,287.39. (R. 49-50.)

In 1959 the taxpayers received cash from such sale in the sums of \$9,944.36, representing payment of the account payable to the taxpayers, and \$4,000 as payment on the \$75,000 promissory note, or a total of \$13,944.36. In addition, the accounts payable of the business in the amount of \$25,568.86 assumed by the corporation as a part of the purchase price were paid by the corporation to creditors during 1959 in the ordinary course of business. (R. 50.)

On April 15, 1960, the taxpayers filed a joint federal income tax return for the calendar year 1959 reporting an income tax liability of \$5,725.05, all of which was duly paid. (R. 50.) Also, on their 1959 return <sup>2/</sup> the taxpayers elected to report the gain from the sale of their business on the installment basis in accordance with Section 453 of the Internal Revenue Code of 1954,

---

<sup>2/</sup> Referred to as Exhibit A in the pre-trial stipulation (R. 12), but not included in the reproduced record.





and reported long-term capital gain in the sum of \$1,157.56 (only 50% of which was taxable) attributable to the \$13,944.36 actually received in 1959.

In auditing the taxpayers' return for 1959, the Commissioner of Internal Revenue determined that the sale of the taxpayers' business did not constitute a sale the gain from which could be reported on the installment method permitted by Section 453 of the 1954 Code. Accordingly, he determined that the sale resulted in long-term capital gain for the year 1959 in the amount of \$20,287.39, of which 50% was includible in taxable income, and, with other adjustments not in issue, assessed an additional tax for the year 1959 in the sum of \$4,915.45, which the taxpayers paid on or about December 27, 1962, with assessed interest in the amount of \$768.52. (R. 50-51.)

The Commissioner's determination that gain on the sale of the taxpayers' business was not taxable on the installment basis was based on the ground that payments received by the taxpayers in the year of sale included the \$25,568.86 in current liabilities of the business assumed by the purchaser as a part of the selling price and actually paid in 1959, and that with this inclusion the payments received by the taxpayers in the year of sale exceeded 30% of the selling price within the meaning of Section 453(b) of the 1954 Code. (R. 51.)

The taxpayers duly filed a claim for refund of \$3,936.23 of the additional taxes paid for 1959 on the ground that they were entitled to report the gain from the sale of their business on the



installment basis. (R. 51.) <sup>3/</sup> Upon failure of the Commissioner to allow the claim for refund, the taxpayers brought this action.

#### SPECIFICATION OF ERRORS RELIED UPON

The District Court erred in holding that, for the purpose of determining whether gain realized by the taxpayers upon the sale of their sole proprietorship business to a corporation in 1959 may be reported on the installment basis, the payments received by them on the purchase price in the year of sale did not, for purposes of Section 453(b) of the Internal Revenue Code of 1954, include the personal obligations of the taxpayers assumed and actually paid during the year of sale by the purchasing corporation as a part of the consideration for the sale.

#### SUMMARY OF ARGUMENT

In general, gain realized on a taxable sale or other disposition of property is taxable in the year of sale for federal income tax purposes. In the case of certain deferred payment sales of property, however, gain may be reported on the so-called installment basis as payments are received. In this case the

---

3/ The alleged overpayment, as computed in a statement attached to the refund claim (R. between pp. 5 and 6) was computed by deducting from the selling price of \$110,513.22 the current liabilities assumed by the purchaser (\$25,568.86) and computing the profit ratio on the basis of a gain of \$20,287.39 and a selling price of \$84,944.36 (23.883%), instead of computing the profit percentage on the basis of the selling price of \$110,513.22 as on their return. This resulted in a computed gain of \$3,330.33 (50% taxable) attributable to the payments of \$13,944.36, rather than a gain of \$1,157.56 (50% taxable) reported on the 1959 return, and the gain of \$20,287.39 (50% taxable) computed by the Commissioner. The complaint alleged overpayment of tax in the amount of \$3,936.23 and overpayment of interest in the amount of \$639.64. (R. 5.)



taxpayers sold their sole proprietorship business to a newly formed corporation in which they retained a controlling interest, the selling price to be paid by the assumption of certain liabilities, including the current accounts payable of the business, and the execution of a purchase money note payable in monthly installments over a period of years. The gain on the sale is taxable on the installment basis only if payments received in the year of sale did not exceed 30% of the selling price, and this in turn depends upon whether such payments include the current accounts payable of the business, which were actually paid by the purchaser in the year of sale.

Payment by a third party of an obligation of the taxpayer represents the constructive receipt of income, or, as in this case, the constructive receipt of payment of a part of the selling price of the business. The current accounts receivable were actually paid by the purchaser in the year of sale, and there is no authority for excluding the amount thus paid in determining whether payments received in the year of sale, for purposes of the installment provisions of the taxing statutes, did not exceed 30% of the selling price. The District Court erred in holding otherwise.





## ARGUMENT

IN DETERMINING WHETHER GAIN FROM THE SALE BY THE TAXPAYERS OF THEIR SOLE PROPRIETORSHIP BUSINESS MAY BE REPORTED ON THE INSTALLMENT BASIS, THE PAYMENTS RECEIVED BY THEM IN THE YEAR OF SALE, WITHIN THE MEANING OF SECTION 453(b) OF THE INTERNAL REVENUE CODE OF 1954, INCLUDED THE PERSONAL OBLIGATIONS OF THE TAXPAYERS ASSUMED BY THE PURCHASER AS A PART OF THE SELLING PRICE TO THE EXTENT SUCH OBLIGATIONS WERE ACTUALLY PAID BY THE PURCHASER IN THE TAXABLE YEAR

That the taxpayers realized a taxable long-term capital gain in the amount of \$20,287.39 upon the sale of their sole proprietorship business in 1959 is not questioned. The only issue for determination on this appeal is whether the realized gain is taxable in full in the year of the sale, as determined by the Commissioner of Internal Revenue, or whether, as claimed by the taxpayers and held by the District Court, such gain may be reported on the installment basis in the years in which payments on the sale price are received.

We respectfully submit the Commissioner properly taxed the gain in the year of sale.

One of the most basic principles of the federal income tax system is that taxable income shall be accounted for on an annual basis, and in accordance with the method of accounting regularly employed by the taxpayer in keeping its books and records. <sup>4/</sup> Thus,

---

<sup>4/</sup> See Sections 441 and 446 of the Internal Revenue Code of 1954, Section 41 of the Internal Revenue Code of 1939, and corresponding sections of prior Revenue Acts.



all income is required to be reported in gross income of the year in which it is received, unless under the method of accounting employed by the taxpayer it is to be accounted for as of a different period, 5/ and all deductions are to be taken in the year in which paid or accrued, according to the method of accounting used in computing taxable income. 6/

One of the major exceptions to this general requirement, commonly known as the installment method of reporting gains and profits, is contained in Section 453 of the Internal Revenue Code of 1954, supra, and the corresponding provisions of prior income tax laws. 7/ Subsection (a) of the latter section provides that under rules prescribed by the Secretary or his delegate, a person who regularly sells or otherwise disposes of personal property on the installment plan "may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the gross profit, realized or to be realized when

---

5/ See Section 451 of the 1954 Code, Section 42 of the 1939 Code, and corresponding sections of prior Revenue Acts.

6/ See Section 461 of the 1954 Code, Section 43 of the 1939 Code, and corresponding sections of prior Revenue Acts.

7/ The installment method of reporting gains and profits is a variation on the cash method, and may be used in reporting gains and profits on sales which come within the statute regardless of whether the taxpayer regularly employs the cash or an accrual method of reporting income. Lucas v. North Texas Co., 281 U.S. 11; Burnet v. Logan, 283 U.S. 404.



payment is completed, bears to the total contract price." 8/  
Subsection (b) of Section 453 upon which these taxpayers rely, further provides that income from a sale or other disposition of real property, or a casual sale or other disposition of personal property for a price exceeding \$1,000, "may (under regulations prescribed by the Secretary or his delegate) be returned on the same basis and in the same manner prescribed in subsection (a)," but "only if in the taxable year of the sale or other disposition--(i) there are no payments, or (ii) the payments (exclusive of evidence of indebtedness of the purchaser) do not exceed 30 percent of the selling price."

In this case, the sale by the taxpayers of their sole proprietorship business to the new corporation in 1959 was a casual sale or other disposition of personal property within the meaning of this provision, and their gain is properly taxable on the installment basis only if the payments received in the year of sale, within the meaning of that subsection, did not exceed 30% of the selling price of \$110,513.22.

The taxpayers contend that only the indebtedness of

---

8/ Paragraph (2) of subsection a provides that for the purposes of paragraph (1) that "the total contract price of all sales of personal property on the installment plan includes the amount of carrying charges or interest which is determined with respect to such sales and is added on the books of account of the seller to the established cash selling price of such property. This paragraph shall not apply \* \* \* with respect to sales or other dispositions of property the income from which is, under subsection (b), returned on the basis and in the manner prescribed in paragraph (1). (Emphasis supplied.)





\$9,944.36 owing to them, which was paid in the year of sale, and the monthly payments aggregating \$4,000 received during 1959 on the purchase money note, which amount to less than 30% of the selling price, constitute payment received in the year of sale. On the other hand, the Government contends that the current liabilities of the taxpayers' business, which were assumed by the purchasing corporation as a part of the selling price and also paid during the taxable year, likewise constitute payment received in the year of sale within the meaning of the statute. It is not the contention of the Government that the mere assumption of the current liabilities of the business resulted in the receipt of payment by the purchasers, for the purposes of Section 453(b), because the assumption of such liabilities only represented one of the conditions of the sales agreement and their amount only represented a part of the consideration to be paid. Rather, it is the contention of the Government that payment of such assumed liabilities, for which the sellers remained primarily liable notwithstanding their assumption by the purchaser as a part of the selling price, represented payment by the purchaser of the selling price to that extent which was constructively received by the sellers in the year of payment--in this case, the year of sale.

The Government's position in this case is wholly consistent with applicable principles of income tax law. Gain from the sale or other disposition of property is determined independently of any statutory requirement for reporting such gain. Gain from the sale or other disposition of property (whether or not it is to be recognized



for income tax purposes and whether or not it is to be reported on the installment basis) is defined in the statute as the excess of the amount realized therefrom over the adjusted basis provided in the statute, and the loss sustained in any such transaction (whether or not deductible for income tax purposes) is the excess of the basis provided in the statute for computing loss over the amount realized. Section 1001(a) of the Internal Revenue Code of 1954. The "amount realized" for the purpose of determining gain or loss is "the sum of any money received plus the fair market value of the property (other than money) received." <sup>9/</sup> Section 1001(b) of the 1954 Code. The "amount realized" for property is not limited to the cash and fair market value of notes or other property actually received by the seller, but is generally the total consideration received, less

---

9/ The "amount realized" for purposes of determining the amount of gain or loss on the sale or other disposition of property is not necessarily the same as the "total contract price" under Section 453(a) for determining "that proportion of the installment payments actually received in that year which the gross profit, realized or to be realized when payment is completed, bears to the total contract price" which is to be returned in income in the payment, or as the "selling price" on which the 30 percent limitation under Section 453(b) is to be computed. For instance, in the case of a deferred payment sale not on the installment method (where more than 30% of the selling price is received in the year of sale), evidence of indebtedness of the purchaser are treated as "property (other than money) received" within the meaning of Section 1001(b) and included at their fair market value in the "amount realized" for the purpose of computing gain or loss. On the other hand, if the sale qualifies as an installment sale taxable under Section 453, and the seller elects to report gain as payments are received, evidence of indebtedness of the purchaser are considered as potentially worth their face value in determining the "total contract price", a proportionate part of which is to be reported as payments are received. In the instant case the "total contract price" for purposes of computing the proportionate amount representing gain under Section 453(a), and the "selling price" for computing the 30 per cent limitation under Section 453(b), was \$110,513.22.



expenses. The "amount realized", "selling price", or "total contract price", for the purpose of computing gain, so far as the present case is concerned, includes the liabilities of the seller assumed by the purchaser. Smith v. Commissioner, 324 F.2d 725 (C.A. 9th), affirming decision of May 28, 1962 (P-H Memo T.C., par. 62,128).

In the cited case, the taxpayer sold his interest in a going business, the only consideration being the purchaser's assumption of current liabilities of the business greatly in excess of the taxpayer's adjusted basis of such assets. The taxpayer elected in his income tax return for the year of sale to report his gain on the so-called return of capital basis (Burnet v. Logan, 283 U.S. 404; Section 1.453-6, Treasury Regulations on Income Tax (1954 Code) ), and attached a statement thereto listing assets in the amount \$284,983.09, liabilities assumed in the amount of \$603,687.96, and an excess of liabilities assumed over assets sold in the amount of \$318,704.87, of which \$142,493.39 was paid by the purchaser as of the end of the year of sale. In affirming the decision of the Tax Court holding the gain in that case taxable in the year of sale, this Court said (324 F.2d, p. 726):

The court properly held, as a matter of statutory construction, that the assumption of personal obligations of a taxpayer by a solvent third person may be treated as "money received" by the taxpayer, within the meaning of Section 1001(b) of the 1954 Code, to the amount of the obligations assumed. Cf. Crane v. Commissioner, 331 U.S. 1, 12-14, 67 S.Ct. 1047, 91 L.Ed. 1301 (1947); Commissioner v. Fortee Properties, Inc., 211 F.2d 915, 916 (2d Cir., 1954); Parker v. Delaney, 186 F.2d 455, 458 (1st Cir., 1950); R. O'Dell & Sons Co. v. Commissioner, 169 F.2d 247,





In Crane v. Commissioner, 331 U.S. 1, cited in the quotation above, real property acquired subject to mortgage later was sold subject to the same mortgage. The Supreme Court held that for the purpose of computing gain on the sale the mortgage balance was includible in the "selling price", although neither the seller nor the purchaser was personally liable on the mortgage. Parker v. Delaney, 186 F.2d 455 (C. A. 1st), cited in the quotation above, is to the same effect. In Commissioner v. Fortee Properties, Inc., 211 F.2d 915 (C. A. 2d), cited in the quotation above, reversing 19 T. C. 99, the court held that the amount of a condemnation award for the taxpayer's property which was paid directly to the mortgagee in discharge of a non-assumed mortgage on the taxpayer's property represented taxable gain to the taxpayer. In R. O'Dell & Sons Co. v. Commissioner, 169 F.2d 247 (C. A. 3d), cited in the quotation above, the court affirmed the decision of the Tax Court, 8 T. C. 1165, holding that where the foreclosure of a mortgage and the sale of the mortgaged property have the effect under applicable state law of discharging the taxpayer's obligations in an amount greater than the adjusted basis of the property, the result is a taxable gain to the taxpayer in the year in which an action for a deficiency judgment becomes barred. Mendham Corp. v. Commissioner, 9 T. C. 320, cited in the quotation above, is to the same effect.

In the instant case, the terms of the sale included assumption



by the purchaser of current liabilities of the taxpayer's business in the amount of \$25,568.86, which amount properly was included in the total contract price of \$110,513.22 in computing the gain of \$20,287.39. The current liabilities assumed by the purchaser were paid in full in 1959, the year of sale. (R. 49-50.) Payment of these current liabilities represented payment by the purchaser of the selling price to that extent. Payment of such liabilities, for which the sellers remained primarily liable notwithstanding their assumption by the purchaser, also represented constructive receipt by the sellers (taxpayers) of payments on the selling price to that extent. Smith v. Commissioner, supra; Commissioner v. Fortee Properties, Inc., supra; R. O'Dell & Sons Co. v. Commissioner, supra. Compare Old Colony Tr. Co. v. Commissioner, 279 U.S. 716; United States v. Boston & M.R. Co., 279 U.S. 732; United States v. Joliet & Chicago R. Co., 315 U.S. 44; Garrison Bros. State Bank v. Commissioner, 67 F.2d 486 (C. A. 9th); Reynolds v. McMurray, 60 F.2d 843 (C. A. 10th); T. K. Harris Co. v. Commissioner, 112 F.2d 76 (C. A. 6th); Tressler v. Commissioner, 228 F.2d 356 (C. A. 9th); Sowell v. Commissioner, 302 F.2d 177 (C. A. 5th); Diescher v. Commissioner, 36 B.T.A. 732, affirmed on another issue, 110 F.2d 90 (C. A. 3d), certiorari denied, 310 U.S. 650.

The taxpayers, in law and in fact, received constructive payment of the purchase price of their business in the amount of \$25,568.86 in 1959 as a result of the payment of assumed current business liabilities in that amount by the purchaser in the year of



sale. It would have been no different from a tax standpoint if the purchaser had paid the \$25,568.86 directly to the taxpayers and they had used the proceeds to pay the accounts payable. Compare Sterling v. Ham, 3 F.Supp. 386 (Me.). These payments, together with the payments admitted by the taxpayers, the payments received in the taxable year of sale exceeded 30% of the selling price, and the gain was properly taxed by the Commissioner as gain from a deferred payment sale not on the installment basis. Cf. Tombari v. Commissioner, 299 F.2d 889 (C.A. 9th). See Treasury Regulations on Income Tax (1954 Code), Section 1.453-6.

Payment of the accounts payable by the purchaser constituted constructive payment of a part of the selling price to the taxpayers, under the facts of this case, for income tax purposes, and the term "payment" as used in Section 453(b) does not have a different connotation. There is no authority, statutory, decisional, or administrative interpretation, other than the District Court's decision in this case, for excluding the \$25,568.86 thus paid by the purchaser in the year of sale from "payments" for the purpose of Section 453(b).

The District Court based its ruling herein on an assumed analogy between the unsecured current liabilities of the sellers assumed by the purchaser in this case and a mortgage indebtedness on the property transferred, which is accorded special treatment under Section 1.453-4(c), Treasury Regulations on Income Tax (1954 Code), supra for purposes of the installment sales provisions of the statute. The latter section provides, so far as material here,





that in the sale of mortgaged property the amount of the mortgage, whether the property is merely taken subject to the mortgage or whether the mortgage is assumed by the purchaser, "shall, for the purpose of determining whether a sale is on the installment plan, be included as a part of the 'selling price, ' " and that "for the purpose of determining the payments and the total contract price as those terms are used in section 453, and §§ 1.453. -1 through 1.453-7, the amount of such mortgage shall be included only to the extent that it exceeds the basis of the property." Thus, the amount of the mortgage, whether or not assumed by the purchaser, is included as part of the selling price upon which the 30% is computed but is not included in the "total contract price" for the purpose of determining the percentage of the payments to be recovered by the seller which is to be returned (either in the year of sale or over the contract period), as income when received, except to the extent that the mortgage exceeds the basis of the property.

There is no statutory authority for this so-called mortgage rule. However, it has appeared in Treasury Regulations since Treasury Regulations 69, Article 44, issued under the Revenue Act of 1926, and has been upheld as reasonable by the Supreme Court. Burnet v. S. & L. Bldg. Corp., 288 U.S. 406. See, also, Commissioner v. South Texas Co., 333 U.S. 496, 502-503. The rule, where appropriate, is applicable to sales or other dispositions of personal property as well as to sales or other dispositions of real property. I. T. 2468, VIII-1 Cum. Bull. 159 (1929); Cisler v. Commissioner, 39 T. C. 458, 465-466. Compare McWilliams v.



Commissioner, 15 B. T. A. 329, 342-343. However, the rule which excludes mortgages, whether or not assumed by the purchaser, for the purpose of determining the amount of "payments" and also for the purpose of determining the proportionate amount of "payments" to be reported as gain under the installment sales provisions of the statute has not been extended to unsecured obligations of the seller assumed and paid by the purchaser as part of the selling price. <sup>10/</sup> On the contrary, such unsecured obligations are included in determining the amount of payments received or to be received (and a corresponding portion of the taxable gain is attributed to them), as well as in determining the "selling price" and the "total contract price."

This method of computing the "selling price" and the "total contract price" applies in cases where the transferred property is subject to a mortgage as well as in cases where no mortgage is involved. In Watson v. Commissioner, 20 B. T. A. 270, a mortgage case, the Board of Tax Appeals failed to include unsecured liabilities of the seller assumed by the purchaser in "payments" received in the year of sale on the sole ground that the evidence

---

<sup>10/</sup> The District Court's reference in its opinion (R. 45-46) to 2 Mertens, Law of Federal Income Taxation (Rev. Ed.), Section 15.16 is with respect to debts of a vendor assumed by the purchaser as being treated in the same way as mortgages. However, the facts here show payment in the year of purchase and with respect to such a situation the same text writer states, 2 Mertens, supra, Section 15.18:

A payment by the purchaser to a third party of an obligation of the vendor in the taxable period is included in the payments \* \* \* .

in the year of sale determining if the payments in the year of sale exceed 30% of the selling price.



failed to show payment. Corona Flushing Co. v. Commissioner, 22 B. T. A. 1344, another mortgage case, such assumed liabilities were paid in the taxable year and were included in "payments" received in the year of sale, with the result that the installment method of reporting gain was inapplicable. In Wagegro Corp. v. Commissioner, 38 B. T. A. 1225, 1228-1229, a non-mortgage case, it was held that a payment by the purchaser of an attorney's fee of \$750 incurred by the seller constituted a part of the selling price of the property. That payment, constructively received by the purchaser in the year of sale, was held to be an "initial" payment under Section 44 of the Revenue Act of 1932, c. 209, 47 Stat. 169, to permit use of the installment method, notwithstanding the fact that no payment on the agreed selling price was received.

McWilliams v. Commissioner, 15 B. T. A. 329, cited by the District Court (R. 45), is not authority for its decision here. The facts of that case, so far as pertinent here, are that a partnership, to whose interest the taxpayer had succeeded, had purchased property for a price of \$440,000, of which \$130,000 remained unpaid at the time of resale by the taxpayer. The latter unpaid balance was assumed by the taxpayer's purchaser. With respect to this assumed liability, the Board of Tax Appeals said in part (pp. 342-343):

In the case before us the unpaid indebtedness of the seller in respect of the property, payment of which was specifically assumed by the purchaser, was not secured by mortgage but in all other respects was similar to a purchase money debt so secured. The seller in the transaction before us had acquired this property under a contract of purchase which obligated him to pay a stated





amount and the party from whom it was acquired retained title under that contract until the payments called for should be all made as provided instead of conveying title and then receiving back the legal title under a mortgage executed to secure the indebtedness. \* \* \* The partnership of McWilliams & Pearson, the purchaser under this contract, and the petitioner, who had succeeded to its interest, had paid all of the purchase price of \$440,000, with the exception of \$130,000 at the time of the resale in 1921 under which the purchaser from this petitioner specifically assumed the payment of this unpaid balance.

In determining whether or not his last sale was one on the installment basis we see no difference between the assumption by the purchaser of the contract obligation of the seller to pay a former owner the balance of \$130,000 due upon the property, and his assumption of a mortgage due that party and representing that item \* \* \* .  
(Emphasis supplied.)

Moreover, it does not appear in the McWilliams case, as it does in the present case, that any payment was made on the assumed purchase price liability during the year of sale.

Denco Lumber Co. v. Commissioner, 39 T. C. 8, relied upon by the District Court (R. 45), is material here, but not as authority for its decision. Rather, to the extent it can be considered applicable, it is in accord with the Government's position in this case. In that case the taxpayers were engaged in the business of subdividing land into house building sites, constructing low-priced houses on those lots, and selling those houses and lots to individual home buyers. With the exception of a few homes, the taxpayers obtained first mortgage loans on the individual properties prior to their sale. When sold, there was no down payment, the purchaser merely assuming the first mortgage and giving the taxpayers a second mortgage for the difference between the first mortgage and the selling price. The Commissioner



determined that under the peculiar circumstances of that case the amount received by the taxpayers upon negotiation of the first mortgage on the property represented payment received on the sale. The Tax Court held (pp. 14-15), however, that the first mortgage loans were bona fide, not a mere device to bring the sales within the provisions of Section 453, and that gain was taxable on the installment basis in accordance with the principles discussed above.

Cisler v. Commissioner, 39 T. C. 458, also relied upon by the District Court (R. 46), likewise does not support its reasoning. In that case the taxpayer in September, 1952, sold 314 shares of preferred stock and 917 shares of common stock in Radio Kentucky, Inc., which he had acquired prior to January 1, 1952. The preferred stock had an adjusted cost basis on the date of sale of \$15,700, and the common stock had a basis of zero. The stock was sold to Radio Kentucky, Inc., in a single transaction, the selling price of the preferred stock being \$15,700, with no gain realized, and the common stock being sold for \$44,300, all of which represented taxable gain. With the consummation of the sales agreement, Radio Kentucky, Inc., cancelled an indebtedness of the taxpayer to it in the amount of \$13,663.53, and paid him cash in the amount of \$2,036.47, a total of \$15,700. Radio Kentucky, Inc., also assumed, as a part of the selling price, an outstanding indebtedness of the taxpayer to a third party in the amount of \$20,000 for the payment of which the taxpayer had pledged his 917 shares of common stock as security. Furthermore, Radio Kentucky,



Inc. gave the taxpayer four promissory notes, the first three for \$4,000 each and the fourth for \$4,300, payable with 5% interest on May 15, 1953, August 15, 1953, January 15, 1954, and March 15, 1954, respectively. During the remainder of the taxpayer's taxable year Radio Kentucky, Inc., paid \$3,000 on the assumed indebtedness and paid \$8,000 on its notes to the taxpayer.

In that case the taxpayer contended that the sale of his stock consisted of two transactions, the sale of his preferred stock, which was paid in full with no resulting profit, and the sale of his common stock for \$44,300 on which he received a payment of \$11,000, of which \$8,000 was paid to him and \$3,000 was paid on his personal liability assumed by the purchaser. (Id., pp. 463-464.) On the other hand, the Commissioner contended that the sale constituted a single transaction with payments on the selling price of \$60,000 amounting to \$43,700 in the year of sale, 11/ and, alternatively, if treated separately, the taxpayer received \$28,000 on the common stock (\$20,000 assumption of indebtedness and \$8,000 in notes) in the year of sale. The Tax Court rejected the contention of the taxpayer, holding, among other things, that the assumption of indebtedness of the seller constituted (p. 465) "Other 'property' " includible in "payments" as that term is used in Section 453(b). The Tax Court further pointed out that the so-called mortgage rule admittedly otherwise applicable under I. T.

---

11/ Consisting of canceled indebtedness of \$13,663.53; cash on consummation, \$2,036.47; assumption of personal indebtedness of \$20,000; payment on notes, \$8,000.





2468, supra, was inapplicable there because the taxpayer's cost basis in the common stock was zero, and under that rule mortgages are excludable from payments only to the extent the mortgage does not exceed the seller's basis of the property.

Moreover, many of the decisions cited above make it clear that an assumption by the purchaser of an indebtedness of the taxpayer to third parties is not to be treated differently, for the purpose of determining "payments" under the statute, from other forms of payment in "Other 'property'." Compare Caldwell v. United States, 114 F.2d 995 (C. A. 3d); Freeman v. Commissioner, 303 F.2d 580 (C. A. 8th). Numerous cases to the same effect could be cited.

Finally, the District Court's conclusion that because under the Regulations mortgages are excluded to the extent they do not exceed the taxpayer's basis in determining "payments" actually received in the year of sale, "by analogy, therefore, it should logically follow that the assumption of plaintiffs' accounts payable should in no way be considered as 'payments actually received in that year' of sale anymore [sic] than the assumption of a mortgage in a real estate transaction is" (R. 45), lacks merit. Mortgage payments frequently extend beyond the period when the seller has received the full amount to be paid him under the sales agreement, and to include subsequent mortgage payments, or even interim mortgage payments, in his income would present many practical difficulties. Burnet v. S. & L. Bldg. Corp., supra, shows that the longstanding regulation with respect to determination of "selling



price" in the sale of mortgaged property is predicated upon the administrative inconvenience which would be incurred if the mortgage were not excluded from the contract price. In S. & L. Bldg. Corp., supra, the taxpayer argued that assumed mortgages should be regarded as part of the contract price and that payments upon them by the purchaser should be treated as money received by the vendor. The taxpayer asserted that this would result in spreading the tax over the entire life of the assumed mortgage. The Court, in rejecting this contention, stated (pp. 414-415):

The amounts which respondent realized as profits are not in question. These were subject to taxation either upon the accrual basis or, at the taxpayer's option, on the installment basis. Generally, the Commissioner's regulations permitted the tax payments to be spread over the period during which the taxpayer would receive funds, and divided these partly into return of capital and partly into profits actually collected. The method suggested by the respondent would inevitably lead to many practical difficulties; might postpone collection far beyond the time when the vendor would receive any direct payments; and probably would render impossible determination from the taxpayer's books of what he should account for. (Emphasis supplied.)

The Secretary of the Treasury, in promulgating his regulations, could have treated other charges against the property, such as mechanic's liens, in the same manner as mortgages. However, he chose not to do so. There is justification for the difference. If a payment on a mortgage were considered as a payment of an installment, the treatment of an installment would be complicated by two sets of installment payments running over two different periods of time. Thus, if a purchaser assumes a mortgage with a ten-year payoff, but was to pay the seller over a



four-year period, numerous difficulties would be encountered. For example, if it were said that each individual payment on a mortgage were to inure to the vendor's benefit, how would the vendor be treated if the purchaser prepaid the balance due on said mortgage after two years instead of ten? How should a vendor be treated if the purchaser were to refinance and obtain a new mortgage for a twenty-year period? It is these problems which the Supreme Court undoubtedly foresaw in S. & L. Bldg. Corp., supra.

Assumption and payment of charges, such as mechanic's liens and/or current liabilities, do not give rise to the difficulties encountered in the mortgage situation. The very nature of these charges would generally result in a single payment by the purchaser or a few payments in a short period of time. The benefit derived by the vendor would be capable of immediate measurement, e. g. , current liabilities paid by the purchaser relieve the vendor of a current obligation. The conjecture and administrative difficulties involved in the mortgage situation would not be present. Accordingly, the reason for the mortgage exclusion does not exist in a situation wherein the purchaser assumed and pays the current liabilities of the vendor. 12/

---

12/ In Rev. Rul. 60-52, 1960-1 Cum. Bull. 186, it is held that in connection with the sale of real property, liabilities of the seller such as liens, accrued interest, and taxes, which are assumed and paid by the purchaser of the property in the taxable year of sale, should be included by the seller as part of the payments received in the year of sale for the purpose of determining whether the transaction was an installment sale subject to the provisions of Section 453(b) of the Internal Revenue Code of 1954. It appears (continued on following page)





## CONCLUSION

The District Court's decision is contrary to the facts and the law. Its judgment should be vacated and the case remanded to that court with directions to dismiss the complaint. 13/

Respectfully submitted,

RICHARD M. ROBERTS,  
Acting Assistant Attorney General.

LEE A. JACKSON,  
I. HENRY KUTZ,  
FRED E. YOUNGMAN,  
Attorneys,  
Department of Justice,  
Washington, D. C. 20530.

Of Counsel:

MANUEL L. REAL,  
United States Attorney.

LOYAL E. KEIR,  
Assistant United States Attorney,  
Chief, Tax Division.

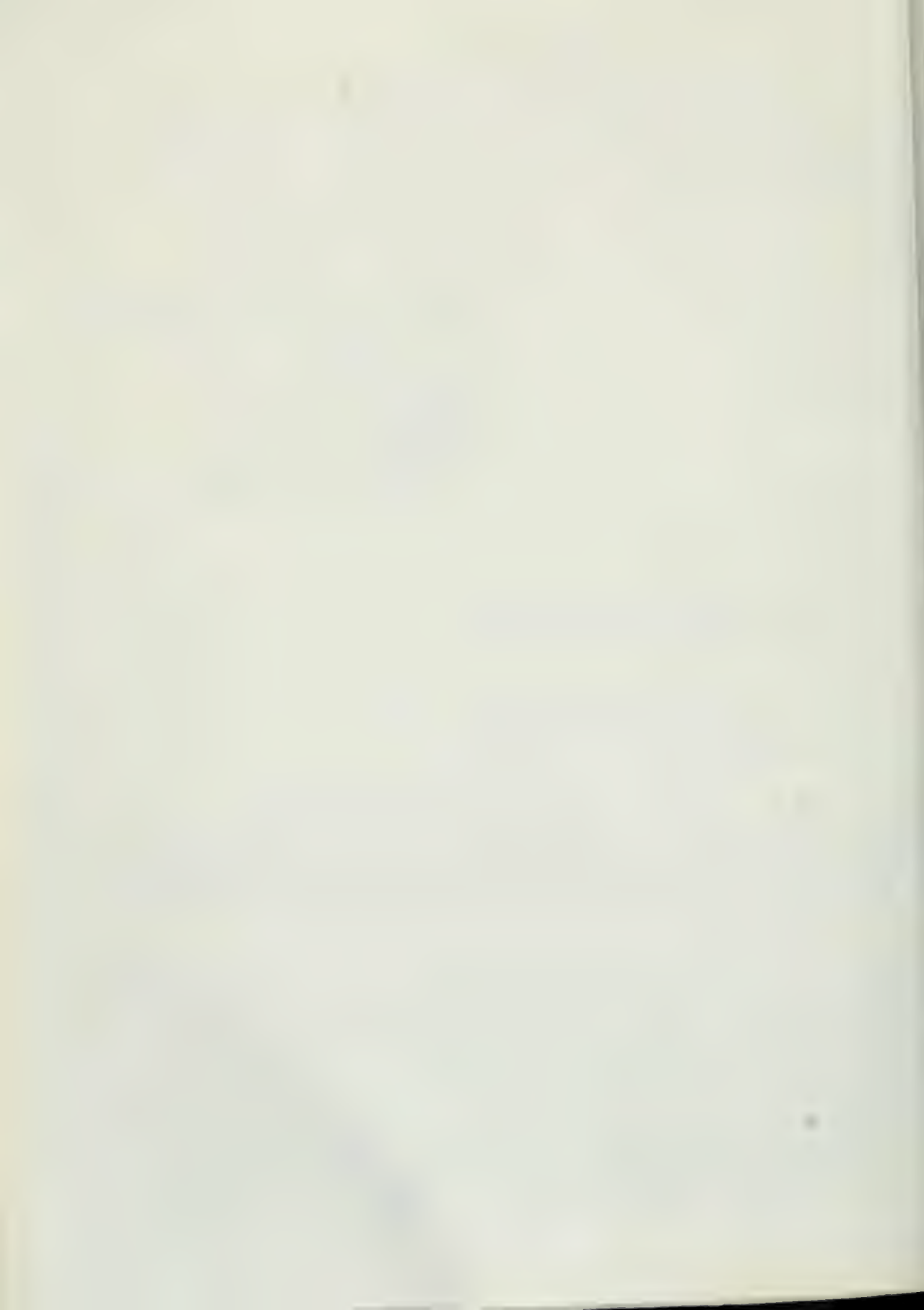
JAMES S. BAY,  
Assistant United States Attorney.

SEPTEMBER, 1965.

---

12/ (continued from preceding page) that this ruling is a logical extension of the proposition that all assumed obligations which are paid in the year of sale should be treated as initial payments under Section 453 unless there are compelling administrative reasons not to so treat them.

13/ In the event that notwithstanding the contentions made by the Government in this brief, this Court should decide to affirm the decision of the District Court, it is suggested that the judgment (R. 53) which now reads that "plaintiffs \* \* \* recover from, defendant UNITED STATES OF AMERICA the sum of \$5,121.30 together with interest from January 4, 1965, at the rate of seventy-five cents (75¢) per day to with \$15.75 making a total payment of \$5137.05" should be rephrased so as to read "IT IS ORDERED, ADJUDGED AND DECREED that plaintiffs JAMES H. MARSHALL and THELMA MARSHALL have judgment against, and recover from, defendant UNITED STATES OF AMERICA as an overpayment (continued on following page)



## CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Dated: 28th day of September, 1965.

/s/ James S. Bay

Assistant United States Attorney

---

13/ (continued from preceding page) the sum of \$4,575.87 with interest thereon as provided by law. " The "law" is 28 U.S.C., Section 2411(a), which provides that interest shall be allowed at the rate of six percent per annum upon the amount of the overpayment, from the date of payment or collection to a date preceding the date of the refund check by not more than thirty days. The figure \$4,575.87 is made up of the deficiency (\$3,936.23) plus assessed interest (\$639.64), which was paid at some date in December, 1962. The sum of \$5,121.30 presently stated in the judgment apparently represents \$4,575.87 plus \$545.43 interest from December 31, 1962 to January 4, 1965. The District Court apparently added \$15.75 interest from January 4, 1965 to date of entry (January 25, 1965). It seems desirable from an administrative viewpoint for purposes of interest calculation that judgments for tax overpayments follow a uniform pattern, such as that suggested above.



**In the United States Court of Appeals  
for the Ninth Circuit**

---

**NATIONAL LABOR RELATIONS BOARD, PETITIONER**

*v.*

**AARON NEWMAN, DANIEL NEWMAN, PAUL NEWMAN  
AND CARL NEWMAN, A PARTNERSHIP d/b/a  
COLONY FURNITURE COMPANY, RESPONDENT**

---

**On Petition for Enforcement of an Order of the  
National Labor Relations Board**

---

**REPLY BRIEF FOR THE NATIONAL LABOR  
RELATIONS BOARD**

---

**ARNOLD ORDMAN,**  
*General Counsel,*

**DOMINICK L. MANOLI,**  
*Associate General Counsel,*

**MARCEL MALLET-PREVOST,**  
*Assistant General Counsel,*

**GARY GREEN,  
BERNARD M. DWORSKI,**  
*Attorneys,*

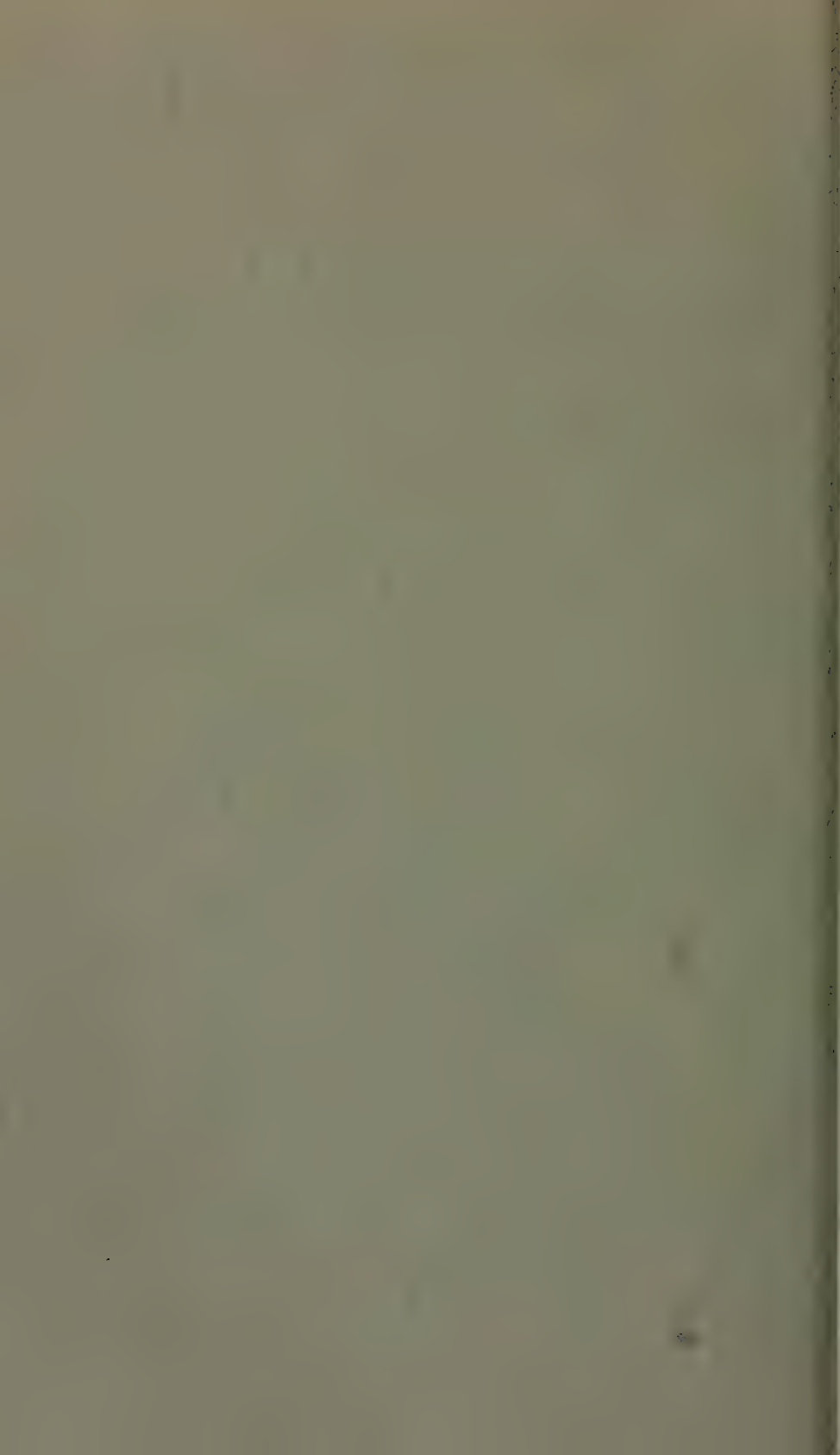
*National Labor Relations Board.*

---

OCT 20 1965

W. H. SCHMID, CLERK





# INDEX

## AUTHORITIES CITED

Cases:	Page
<i>J. I. Case Co. v. N.L.R.B.</i> , 321 U.S. 332 .....	3
<i>The Frito Co. Western Div. v. N.L.R.B.</i> , 330 F. 2d 458 (C.A. 9) .....	4
<i>Lloyd A. Fry Co. v. N.L.R.B.</i> , 216 F. 2d 273 (C.A. 9) .....	4-5
<i>N.L.R.B. v. Fitzgerald Mills Corp.</i> , 313 F. 2d 260 (C.A. 2), cert. den., 375 U.S. 834 .....	5
<i>N.L.R.B. v. Holly-General Co.</i> , 305 F. 2d 670 (C.A. 9) .....	3
<i>N.L.R.B. v. Gene Hyde</i> , 339 F. 2d 568 (C.A. 9)....	3, 6
<i>N.L.R.B. v. Andrew Jergens Co.</i> , 175 F. 2d 130 (C.A. 9), cert. den., 338 U.S. 827 .....	4
<i>New England Die Casting Co.</i> , 116 NLRB 1 .....	7
<i>Operating Engineers Local Union No. 3</i> , 123 NLRB 922 .....	7
<i>Sheet Metal Workers Union, Local Union No. 65</i> , 120 NLRB 1678 .....	7
<i>Warrensburg</i> , 143 NLRB 398, enf'd, 340 F. 2d 920 (C.A. 2) .....	6, 7
Miscellaneous:	
McCormick, <i>Evidence</i> , § 226 (1954) .....	2



**In the United States Court of Appeals  
for the Ninth Circuit**

---

No. 20,108

NATIONAL LABOR RELATIONS BOARD, PETITIONER

*v.*

AARON NEWMAN, DANIEL NEWMAN, PAUL NEWMAN  
AND CARL NEWMAN, A PARTNERSHIP d/b/a  
COLONY FURNITURE COMPANY, RESPONDENT

---

**On Petition for Enforcement of an Order of the  
National Labor Relations Board**

---

**REPLY BRIEF FOR THE NATIONAL LABOR  
RELATIONS BOARD**

---

1. Respondent argues that the Board violated the hearsay rule by admitting into evidence union representative Taylor's testimony about a Taylor conversation with Federal Conciliator Medoff. But the argument lacks merit: the remarks attributed by Taylor to Medoff were considered only for a limited purpose and not to show the truth of their contents.

Thus, Taylor was reluctant to meet with Aaron Newman, as requested, after terms had been concluded with Daniel. But Taylor consented to the meeting, after expressing unwillingness to engage in any further negotiation, when Conciliator Medoff assured him that there would be no such problem because Daniel had agreed to sign the contract if Aaron did not. To this day, respondent argues that there was no contract at this point and, to buttress its argument, contends that even Taylor did not believe there was a firm agreement (Br. 19-20). The Board's reliance upon the Taylor-Medoff conversation was obviously proper, therefore, to show that Taylor's subsequent meeting with Aaron was *not* inconsistent with Taylor's belief that a contract had already been reached. With reference to the issue of why Taylor met with Aaron Newman, the truth of Medoff's statement is not an issue and the Board therefore could properly consider Taylor's testimonial account of that statement.<sup>1</sup> McCormick, *Evidence*, § 226 (1954).

---

<sup>1</sup> With reference to the issue of whether Daniel had actually promised to sign the agreement, there was sufficient evidence in the record for the Board's finding, without reference to the Medoff remark. See our opening brief, pp. 6-8. Respondent does not impair the validity of this finding by showing that Taylor waited for an indication of assent from the Company before submitting the drafted agreement to the Union for ratification. The existence of a contract was mutually acknowledged at the May 18 meeting and the Union then undertook the task of preparing a formal integrated document. One need not assume that Taylor waited thereafter for Company approval because he feared the agreement was not binding. At this stage, Taylor simply did not know if the draft he prepared constituted an accurate embodiment of the agreement already reached. (Tr. 91-92).

2. Respondent now objects to enforcement of the Board's order on the ground that it may impair employee rights. Specifically, respondent notes that there are compulsory membership and dues checkoff provisions in the dishonored contract. According to respondent, enforcement of the Board's order will require "illegal consequences" (Br. 42) by subjecting current employees to the obligations retroactively and prospectively. This belated concern for the rights of employees is misplaced: in ordering respondent to execute its agreement with the Union, the Board did not adjudicate or effectively determine, adverse to such employees, any privileges which they may have acquired during the contract's hiatus.<sup>2</sup> See *J. I. Case Co. v. N.L.R.B.*, 321 U.S. 332, 339-341; and *N.L.R.B. v. Gene Hyde*, 339 F. 2d 568, 573 (C.A. 9). None of the contract terms here are unlawful on their face, nor does respondent show that its own compliance with the Board's order will necessarily impair employee rights. The rest is all speculation.

With respect to the problems of dues and checkoff that respondent anticipates, it is enough at this point to note that such problems need not arise; that the Board's processes are available to aggrieved employees if they do; and that the Company and the Union can, by their own lawful conduct in the future, prevent such problems from arising. "The order to bargain

---

<sup>2</sup> Nor does the possibility that the Union may no longer have support of a majority of the current employees alter this case. *N.L.R.B. v. Holly-General Co.*, 305 F. 2d 670, 673-675 (C.A. 9), and cases cited.



means to do so within the prescribed limits of the law.” *N.L.R.B. v. Andrew Jergens Company*, 175 F. 2d 130, 134 (C.A. 9), cert. den., 338 U.S. 827.

3. As shown in our opening brief, p. 8, the Board found violation of Section 8(a)(5) here not only because of respondent’s refusal to execute the agreement reached on May 18, 1962, but also because of tactics used by respondent, between September 1961 and March 1962, evidencing bad faith in negotiations. This Board finding is challenged on two grounds. First, respondent contends that its repeated shifting of bargaining authority from one Company representative to another “was never put in issue or litigated” (Br. 24). The record refutes this contention. Thus, the General Counsel’s complaint—even the portion quoted in respondent’s brief, p. 24—shows that bad faith conduct of negotiations was expressly and separately alleged, in addition to the refusal to sign the agreement reached. Furthermore, respondent had ample opportunity to respond at the hearing when the evidence was adduced describing the conduct which tended to prove this violation. Whether as respondent states (Br. p. 26) the Regional Director may have disagreed with the Trial Examiner’s view that this conduct was unlawful is immaterial since—as respondent concedes (*ibid.*)—the Examiner’s findings were explicit and permitted exceptions to be taken to the Board. *The Frito Company Western Div. v. N.L.R.B.*, 330 F. 2d 458 (C.A. 9).

Second, respondent challenges this Board finding of bad faith by citing inappropriate cases. *Lloyd A.*

*Fry Roofing Co. v. N.L.R.B.*, 216 F. 2d 273, 276 (C.A. 9), *N.L.R.B. v. Fitzgerald Mills Corp.*, 313 F. 2d 260, 267 (C.A. 2), cert. den., 375 U.S. 834, and the like, merely hold that a company otherwise bargaining in good faith does not violate Section 8(a)(5) because it has not empowered its representative to *execute* a binding agreement. Here, the Board found a violation of Section 8(a)(5) because of a different and more fundamental problem: respondent failed, between September 1961 and March 1962, to make available an authorized *negotiator* for face-to-face bargaining.

4. Respondent's attack on the Board's remedial order rests upon three claims advanced in respondent's brief at pp. 29, *et seq.*: (1) the claim that the Board's original Order of November 1963 was clear and unambiguous (2) the claim that the dishonored contract was for a one-year term, and (3) the claim that the Board's clarifying order of September 1964 was issued in disregard of procedural requirements. Since all three claims are demonstrably incorrect, respondent's attack must fail.

The first claim focuses upon the language used by the Board in its original order. Respondent contends that when it was ordered to "execute the agreement reached on May 18, 1962" this order necessarily contemplated that the terms of that agreement were to be applied for a period commencing with the actual date of execution. But the Union read this order to mean that the effective period of the contract should commence as of the time respondent should have signed

it.<sup>3</sup> There is no need now to labor the question of whose interpretation of the order was correct, for the Board itself has answered that question: the Union's interpretation was correct. Respondent does not and cannot challenge the Board's power to require such retroactive application of a repudiated contract.<sup>4</sup> Instead, respondent persists in its view that only prospective application was originally intended by the Board. We have already shown that this view is erroneous, as illustrated by the Board's reference to the *Warrensburg* case (143 NLRB 398, enf'd, 340 F. 2d 920 (C.A. 2)) in its original order. See our opening brief, p. 24. It is true, as respondent points out (Br. 33), that there were other legal issues in *Warrensburg*, to which the Board's reference might have been directed, such as the optional feature of the order whereby the Union might choose either the negotiated contract or further bargaining. But that merely goes to show that the Board was correct in concluding that explicit clarification of its original order would be appropriate; it cannot mean that the Board originally intended only a prospective application of the con-

---

<sup>3</sup> Respondent concedes that the Union "stood fast" on its view of the proper date for commencing contract application (Br. 9, 40). Therefore, we need not discuss further respondent's objection to the fact that the Board took administrative notice of the existence of a dispute between the parties over interpretation of the Board's original order.

<sup>4</sup> See, e.g., *N.L.R.B. v. Gene Hyde*, 339 F. 2d 568, 571 (C.A. 9), where the Court explained that the purpose of a Board order in a case like this is "placing the parties, with reference to the contract, back in the position which they occupied prior to the breach."

tract, because the *Warrensburg* order itself required retroactive application.<sup>5</sup>

In short, the Board's original order did not expressly and unambiguously apprise the parties of the intended date for commencing application of the contract; the Board acknowledged this lapse; and a subsequent directive issued to make explicit what was only implicit before. Respondent's basic dispute with the propriety of such corrective action is that it had the effect of "imposing new and different obligations on respondent." This brings us directly to respondent's second claim, i.e., that it had only agreed to a contract for a one year period; for only if this claim is true can it be said that the Board's order imposes an obligation upon respondent any different from what it had actually agreed to. We concede, of

---

<sup>5</sup> Respondent is clearly wrong in stating that the Board's "customary remedy" is to require the contract terms to become effective only upon actual execution of the contract. In cases where the Board has ordered execution of a contract, the period of effective duration of the contract is not a matter of "custom." Rather, the Board has shaped its orders in each such case so as to grant a fair, effective and meaningful remedy in light of all the circumstances. Such considerations as the original intentions of the parties regarding contract duration, the amount of time elapsed since the violation, and the interim conduct of the violator have properly been considered. Thus while *New England Die Casting Co.*, 116 NLRB 1, 5, set the effective date of the contract to commence upon actual execution, cases like *Sheet Metal Workers Union Local No. 65*, 120 NLRB 1678, 1679; *Operating Engineers Local Union No. 3*, 123 NLRB 922; and *Warrensburg*, 143 NLRB 398, 399 all required retroactive application of the contract terms.



course, that a Board order requiring application of a contract for a longer effective period than that agreed to by the parties would constitute an exercise of remedial authority requiring prior notice to the parties. We likewise agree with respondent (Br. 32) that such an order would be a departure from Board precedent. But we cannot agree that such an order is here involved.

Despite respondent's frequent references to the contract in this case as being for a one-year term (Br., pp. 30, 39, 41), this description is simply inaccurate: the parties themselves deliberately and undeniably left the terminal date of their agreement open, contemplating long-range prospective application absent notice of a contrary intent. Therefore, the Board's order does not contravene the parties' intention regarding the duration of contract application. Respondent's contrary assumption is analogous to the objection a tenant might raise under a typical lease agreement executed for a one-year period with a provision for automatic year-to-year renewal absent timely notice. Failing to supply timely notice, the tenant would be liable to pay rent for more than a one-year period; but he could hardly accuse the court of subjecting him to a "new and different" obligation.

What we have already said also disposes of respondent's third claim, *i.e.*, that the Board's clarifying order issued without procedural prerequisites. For we do not understand respondent to be contending that a true clarification by the Board requires prior notice; its position, rather, is that the order of

September 1964 was a "modification" and not a clarification. That argument, as we have just demonstrated, rests wholly upon the erroneous view that the contract, here was only for a one-year period. Once the contract is acknowledged to provide for automatic renewal, it becomes perfectly clear that it is the contract provision itself, and respondent's own continuing refusal to comply therewith, which results in the progressive extension of the effective period of the contract. It is only because respondent agreed to, and then refused to honor, an agreement with no fixed terminal date that the contract period and the consequent costs of compliance continue to mount. The Board's September 1964 order "modified" nothing.

Finally, respondent concedes that it agreed to a contract with an automatic renewal provision (Br. 37) but blames the Board for depriving it of the recurring opportunities to terminate the contract by timely notice. Again, this argument attributes to the Board's order consequences which flow from respondent's conduct. Each of the Board's orders preserves respondent's right to terminate at the next opportunity; respondent has never yet sought to exercise this privilege. When respondent seeks to excuse this inaction on the grounds that "there was no occasion for respondent to give notice . . . [because] a contract [had not yet] come into existence . . ." (Br. 38), it merely reveals that the whole attack on the Board's remedy is premised on the assumption that



there never was any unlawful repudiation of an agreement to begin with.

Respectfully submitted,

ARNOLD ORDMAN,  
*General Counsel,*

DOMINICK L. MANOLI,  
*Associate General Counsel,*

MARCEL MALLET-PREVOST,  
*Assistant General Counsel,*

GARY GREEN,  
BERNARD M. DWORSKI,  
*Attorneys,*

*National Labor Relations Board.*

October 1965.

#### CERTIFICATE

The undersigned certifies that he has examined the provisions of Rules 18 and 19 of this Court, and that in his opinion the tendered brief conforms to all requirements.

---

Marcel Mallet-Prevost  
Assistant General Counsel  
NATIONAL LABOR RELATIONS BOARD

---

---

IN THE  
**United States Court of Appeals**

FOR THE NINTH CIRCUIT

---

**No. 20,108**

---

NATIONAL LABOR RELATIONS BOARD, *Petitioner*

v.

AARON NEWMAN, DANIEL NEWMAN, PAUL NEWMAN  
AND CARL NEWMAN, A PARTNERSHIP D/B/A  
COLONY FURNITURE COMPANY, *Respondent*

---

**On Petition for Enforcement of Orders of  
the National Labor Relations Board**

---

**BRIEF FOR RESPONDENT**

---

**FILED**

SEP 20 1965

RANK H. SCHMID, CLERK

JOSEPH C. WELLS  
WINTHROP A. JOHNS  
1120 Tower Building  
Washington, D. C. 20005  
*Attorneys for Respondent*

*Of Counsel:*

REILLY AND WELLS  
1120 Tower Building  
Washington, D. C. 20005



## SUBJECT INDEX

	Page
I. COUNTERSTATEMENT OF THE CASE .....	2
II. SPECIFICATION OF ERRORS .....	13
III. ARGUMENT .....	15
A. The Record as a Whole Does Not Support the Board's Findings .....	15
1. Daniel's meeting with employees .....	15
2. Respondent's Request in June and July to Reopen Negotiations on Arbitration .....	18
a. Daniel did not have authority to conclude a contract without Aaron's ratification ..	18
b. Assuming Daniel's authority to conclude an agreement, Aaron's request for further negotiation on arbitration did not violate the Act .....	21
B. The So-called Divided and Fluctuating Bargaining Authority Was Not Alleged or Litigated .....	24
C. The Board's Orders .....	29
1. The September 1964 order did not clarify, it modified and set aside the November 1963 decision and order .....	30
2. The Board's modification of its November 1963 decision and order exceeded its authority and was a nullity .....	35
3. Respondent is prejudiced by the Board's September 1964 order .....	37
4. The Board's September 1964 order requires respondent and its employees to submit to illegal contract provisions .....	40
D. Respondent Is Under No Lawful Obligation to Further Recognize or Bargain With The Union Pending an Election .....	42
IV. CONCLUSION .....	43

	Page
APPENDIX A .....	45
APPENDIX B .....	50
APPENDIX C .....	52

### AUTHORITIES CITED

#### CASES:

<i>American Power &amp; Light Co. v. S.E.C.</i> , 329 U.S. 90 ...	36
<i>Arkansas Louisiana Gas Co.</i> , 154 NLRB No. 72, 60 LRRM 1055 .....	23
<i>Crowell v. Benson</i> , 285 U.S. 22 .....	36
<i>Great Western Broadcasting Corp., d/b/a KXTV</i> , 139 NLRB 93 .....	28
<i>Lansenberg Hat Co.</i> , 116 NLRB 198 .....	39
<i>Leedom v. Kyne</i> , 249 F.2d 490 (C.A.D.C.), aff'd 358 U.S. 890 .....	37
<i>Lloyd A. Fry Roofing Co. v. N.L.R.B.</i> , 216 F.2d 273 (C.A. 9) .....	28
<i>McLean-Arkansas Lumber Co.</i> , 109 NLRB 1022 .....	28
<i>Midwestern Instruments, Inc.</i> , 133 NLRB 1132 .....	28
<i>N.L.R.B. v. Almeida Bus Lines, Inc.</i> , 333 F.2d 729 (C.A. 1) .....	28
<i>N.L.R.B. v. Bradley Washfountain Co.</i> , 192 F.2d 144 (C.A. 7) .....	26
<i>N.L.R.B. v. Fitzgerald Mills Corp.</i> , 313 F.2d 260 (C.A. 2) .....	28
<i>N.L.R.B. v. H. E. Fletcher Co.</i> , 298 F.2d 594 (C.A. 1) ..	26
<i>N.L.R.B. v. Hibbard</i> , 273 F.2d 565 (C.A. 7) .....	28
<i>N.L.R.B. v. Johnson</i> , 322 F.2d 216 (C.A. 6) .....	26
<i>N.L.R.B. v. Nesen</i> , 211 F.2d 559 (C.A. 9), cert. denied 348 U.S. 820 .....	23
<i>New England Die Casting Co.</i> , 116 NLRB 1 .....	32
<i>Northwest Photo Engraving Co.</i> , 106 NLRB 1067 ....	39
<i>Phelps Dodge Corp. v. N.L.R.B.</i> , 313 U.S. 177 .....	32
<i>Service v. Dulles</i> , 354 U.S. 363 .....	36
<i>Sheet Metal Workers Union (Inland Steel Products Co.)</i> , 120 NLRB 1678 .....	32
<i>Henry I. Siegel</i> , 147 NLRB 594, enf'd 340 F.2d 309 (C.A. 2) .....	32
<i>Squirrel Brand Co.</i> , 104 NLRB 289 .....	39
<i>Times Square Stores Corp.</i> , 79 NLRB 361 .....	26

## Page

<i>U.S. ex rel. Accardi v. Shaughnessy</i> , 347 U.S. 260 . . . . .	36
<i>Wait, Inc.</i> , 132 NLRB 1338 . . . . .	32
<i>Warrensburg Board &amp; Paper Corp.</i> , 143 NLRB 398 . . . . .	32, 33

## STATUTES:

National Labor Relations Act (29 U.S.C., Sec. 151  
*et seq.*)

Sec. 3(d) . . . . .	26, 50
Sec. 8(a)(1) . . . . .	7, 8, 14
Sec. 8(a)(3) . . . . .	41, 50
Sec. 8(a)(5) . . . . .	7, 8, 14
Sec. 9(a) . . . . .	41, 51
Sec. 10 . . . . .	34
Sec. 10(c) . . . . .	29
Sec. 10(d) . . . . .	11, 34, 36
Sec. 10(e) . . . . .	15

Labor Management Relations Act, 1947 (29 U.S.C. Sec.  
186)

Sec. 302 . . . . .	11, 13, 42, 51
--------------------	----------------

## MISCELLANEOUS:

National Labor Relations Board Rules and Regulations  
and Statements of Procedure, Series 8, as amended

Sec. 102.49 . . . . .	34, 35
-----------------------	--------





IN THE  
**United States Court of Appeals**  
FOR THE NINTH CIRCUIT

---

No. 20,108

---

NATIONAL LABOR RELATIONS BOARD, *Petitioner*

v.

AARON NEWMAN, DANIEL NEWMAN, PAUL NEWMAN  
AND CARL NEWMAN, A PARTNERSHIP D/B/A  
COLONY FURNITURE COMPANY, *Respondent*

---

**On Petition for Enforcement of Orders of  
the National Labor Relations Board**

---

**BRIEF FOR RESPONDENT**

---

Respondent, Colony Furniture Company, files this brief in opposition to the Board's petition for enforcement of its orders in this matter. Respondent opposes enforcement of the orders on the grounds that: (1) the Board's orders are predicated on findings not supported by "the record

considered as a whole" and, in part, on matters not charged in the Complaint or litigated; (2) nonetheless, respondent fully complied with the order of the Board of November 15, 1963 (R. 41-43); (3) the so-called "Order Clarifying Decision" of September 14, 1964, is a nullity because issued in excess of statutory authority and in violation of the Board's own Rules and Regulations, and because it imposes illegal contract provisions on respondent and its employees (R. 46-48); and (4) the Board improperly refused to conduct an election on the petition filed by respondent on about February 5, 1965, because, due to the passage of time and the turnover of personnel in the bargaining unit, respondent is under no lawful obligation to recognize or bargain with the Union unless and until it demonstrates in an election that it currently represents respondent's employees.

### **I. COUNTERSTATEMENT OF THE CASE**

In 1960, respondent voluntarily recognized the Union. Aaron Newman, the senior partner, and his son, Daniel, both negotiated with the Union on the terms of the agreement which was signed by Daniel on June 7, 1960, effective to July 1, 1961 (Tr. 111-112, 45-46). As during the 1961-1962 contract negotiations, those here involved, Aaron was not always present during the 1960 negotiations (Tr. 111). However, the agreement of Aaron, as well as of Daniel, was secured before the 1960 contract was signed by Daniel (Tr. 111-112).

Upon expiration of the first contract on July 1, 1961, respondent petitioned the Board for an election to determine whether, in fact, the Union did represent its employees. The election was won by the Union, which was certified on September 6, 1961 (Tr. 46-47). In the latter part of September 1961, negotiations for a new contract commenced with Aaron attending on behalf of respondent (Tr. 46-47). At the next meeting, held the first week in October, Daniel attended as respondent's representative (Tr. 48-49). At

this meeting, as Union Representative Taylor admitted (Tr. 49-50), the discussion related to "the health and welfare problem", "pension plan", "dues deduction, initiation fees", "grievance and arbitration", and "the question of back dues that the people owed". The Union left to respondent's election whether "to keep their present health and welfare plan" or adopt the Union's (Tr. 49-50). It was shortly after this negotiation meeting that Daniel held his meeting with the employees (see Bd. Br., p. 4). This meeting is discussed hereinafter (*infra*, pp. 15-17).

Thereafter, the Union filed a charge with the Board alleging that Daniel's statements to the employees at the meeting violated Sections 8(a)(1) and (5) of the Act (Case No. 21-CA-4549). Meanwhile, negotiations between the parties continued without interruption (Tr. 52-56). Ultimately, on January 12, 1962, in order to get rid of this baseless charge, and expressly disclaiming any admission of a violation of the Act, respondent entered into a settlement agreement (R. 9-10). Pursuant to the settlement agreement, the Regional Office of the Board was kept informed of the negotiations between the parties. On April 30, 1962, the Regional Director "closed" Case No. 21-CA-4549, stating that respondent had "complied with the provisions of the Settlement Agreement" (G.C. Ex. 1(i)).

During this period, there was no interruption to bargaining (Tr. 52-56). It was conducted much as it was during negotiation of the original contract. Except for the first meeting, and one on January 18, Aaron did not personally attend the negotiation meetings (Tr. 62-63, 123, 145). However, the Union knew that Aaron's approval would have to be secured to any final agreement before it would be signed. Aaron represented respondent at the first bargaining meeting in September (Tr. 47). Although the Union claimed that Aaron at this first meeting said that Daniel "would negotiate the contract and sign it with the union" (Tr. 48), it is clear that whenever a troublesome question arose during negotiations Daniel telephoned

Aaron so the Union representative could discuss the matter directly with Aaron (Tr. 61-63, 122-123, 128-132, 144). The January 18 meeting with Aaron (Tr. 123, 145) was set up by Daniel in an effort to resolve existing differences between Aaron and the Union, at which meeting Aaron "did most of the talking" (Tr. 145). In addition, the Union representative corresponded directly with Aaron, not Daniel, regarding matters (G.C. Ex. 8-10). Finally, the Union representative admitted that during negotiations Daniel told him "that he would have to get the approval of his father before he would sign the agreement" (Tr. 61; see also Tr. 143-144, 148).

From the beginning of negotiations in 1961, one of the stumbling blocks to the conclusion of a contract was Aaron's adamant opposition to arbitration (Tr. 55-56, 61, 102, 112-113, 120-121, 124). In an effort to break the deadlock, Aaron on February 28, 1962, sent the Union a contract proposal containing, *inter alia*, provisions for arbitration but reserving to respondent "sole" determination of employee qualifications in layoff situations (G.C. Ex. 7, 8). The Union, however, on March 6, 1962, in effect rejected this proposal and invoked the aid of the Federal Mediation Service (G.C. Ex. 10).

The first meeting before the Federal Conciliator occurred the "third week in March" with Daniel representing respondent (Tr. 76). One of the obstacles to an agreement was the Union's insistence upon a pension plan (Tr. 76). The Conciliator suggested that negotiations be suspended until the Union representative ascertained from the Union "executive board" whether this demand could be dropped (Tr. 78). After the "executive board" authorized abandonment of this demand, the parties met on May 18, 1962, again with Daniel representing respondent (Tr. 79). At this meeting, Daniel, as he had in the past, initially resisted the Union's arbitration demands because of his father's opposition to them (Tr. 79, 89-90). Upon being shown Aaron's contract proposal of February 28, provid-

ing for arbitration, and Aaron at the time being in a Boston hospital undergoing surgery and unavailable for consultation (Tr. 146), Daniel capitulated (Tr. 79-80, 89-90, 107). Moreover, under pressure from the Conciliator, Daniel also agreed to modify Aaron's February 28 proposal to make respondent's determination of employee qualifications in layoff situations reviewable under the grievance and arbitration procedures (Tr. 80-81, 141; G.C. Ex. 7, Art. V). After some give and take on other matters, Daniel and the Union reached agreement with the understanding that the Union would set forth the agreement in a written contract and forward same to Daniel (Tr. 89, 93). This the Union did on about June 8 (Tr. 93-94). The contract was to be for a fixed period of one year, automatically renewable from year to year unless terminated by notice (Tr. 92; G.C. Ex. 14, p. 8).

When Daniel received the written contract, he forwarded it to Aaron for ratification (Tr. 145). Aaron, however, at this time was back in the Boston hospital for a check-up on the results of the previous month's operation (Tr. 145-146). About a "week or 10 days" after June 8, the Union's representative telephoned Daniel regarding the contract, saying he "had to have the contract signed by the company or an indication that they were going along with that, so that I could call the people together to have them ratify the agreement so I could sign it" (Tr. 97, 152).<sup>1</sup> Thereafter, Daniel telephoned Aaron at the hospital to discuss the matter (Tr. 146, 150, 155). Aaron pointed out that recent "Supreme Court decisions made it very dangerous for an employer to put an arbitration clause in the contract without specifically spelling out what issues were to be arbitrated" and that he would like to meet with the Union "himself and discuss these things" when he could come to California in July (Tr. 146, 150, 155). Pursuant to this a meeting between the Union's representative and

---

<sup>1</sup> This quote is from the testimony of the Union's principal negotiator, Roy Taylor (Tr. 43).



Aaron was arranged for and held on the "second Saturday in July," which was July 14 (Tr. 100).<sup>2</sup>

At the July 14 meeting, Aaron reminded the Union representative that he was opposed to arbitration "right from the start" (Tr. 101), and stated that while he had agreed to it in his February contract proposal recent court decisions had caused him to have "a change of heart" (Tr. 120-121). The Union representative, however, refused to discuss revision of the agreement negotiated with Daniel and said "Sign it or I am going to the National Labor Relations Board", and walked out of the meeting when Aaron stated that he had come to the meeting at 8:30 a.m. on a Saturday morning "in good faith to talk to him about this contract" (Tr. 150-151, 101).

Thereafter, the Union made no attempt to meet with respondent in an effort to resolve Aaron's objection to the arbitration provisions. Instead, on July 30, 1962, the Union filed the initial charge in Case No. 21-CA-4906, claiming a violation of Section 8(a)(5) of the Act because of respondent's refusal to execute the agreement as reached on May 18, 1962 (R. 11). Subsequently, the Union on September 26 and 28, 1962, filed amended charges, also restricting their allegation of a Section 8(a)(5) violation to refusal to

---

<sup>2</sup> The Trial Examiner (R. 26), and the Board in its brief (p. 8), erroneously fix the meeting as occurring on "about July 18." However, the Union's representative stated that the meeting occurred on the "second Saturday in July" (Tr. 100), which the calendar shows was July 14, 1962. Also, the Board in its brief (pp. 7-8), as did the Trial Examiner (R. 26), recites alleged conversations between the Union representative and the Conciliator. Objection to receipt of testimony as to these conversations was timely raised by respondent on the ground of "hearsay on hearsay" (Tr. 100, 98). The Trial Examiner stated, however, that he would receive the testimony solely to "get a sequence" "step by step" (Tr. 100). It plainly was error for the Trial Examiner thereafter to make use of this challenged hearsay evidence to support his findings, and for the Board in its brief before this Court to reiterate it as support for the Board's adoption of the Trial Examiner's findings. If the objectionable hearsay testimony were regarded as insignificant, it would not have been recited by the Trial Examiner and repeated by the Board in its brief.

execute the agreement (R. 12, 13). Thereafter, the Regional Director set aside the settlement in Case No. 21-CA-4549 and issued his Consolidated Complaint on all the Union's charges (R. 14-19).

On February 21, 1963, the Trial Examiner of the Board, after hearing on the Complaint, issued his Intermediate Report and Recommended Order (R. 23-24). The Trial Examiner found that respondent violated Sections 8(a)(1) and (5) of the Act, assertedly (1) by Daniel "attempting to undermine the Union" by his October 1961 meeting with the employees; (2) "by confronting the Union in negotiations with a divided and fluctuating bargaining authority", meaning Aaron and Daniel; and (3) by refusing "to execute a contract it agreed to on May 18, 1962" (R. 31). To remedy the asserted unfair labor practices, the Trial Examiner, among other things, recommended that respondent be directed to "Forthwith execute the bargaining agreement reached by its negotiator and the Union's negotiator on or about May 18, 1962" (R. 32).

Respondent duly filed exceptions to the Intermediate Report and Recommended Order (R. 35-40), supported by brief with record references challenging the findings and order as unsupported by the record. As to the finding that respondent violated the Act by bargaining through both Aaron and Daniel, respondent pointed out in addition that such was *never alleged in the Union's charges or the General Counsel's Complaint, or litigated at the hearing*, as a violation of the Act (R. 39).

On November 15, 1963, the Board issued its Decision and Order (R. 41-43) in this matter in which, after reciting that it "hereby adopts the Trial Examiner's findings, conclusions, and recommendations with the modifications noted herein", it stated solely in the decisional part (R. 41-42) that:

"We agree with the Trial Examiner's finding, and for the reasons stated by him, that Respondent did

not bargain in good faith with the Union and thereby violated Section 8(a)(5) and (1) of the Act. We note particularly that, as found by the Trial Examiner, Aaron Newman held out his son Daniel as having authority not only to negotiate, but also to conclude an agreement with the Union, and that after Daniel, pursuant to this representation, agreed upon terms of a new collective-bargaining agreement, Aaron repudiated his son's actions. We note Respondent's defense that, as the employees could reject an agreement concluded by their negotiator, so Respondent should be free to disavow the agreement of its representative. However, it is patent that Respondent understood at all times during the negotiations that any agreement reached would have to be ratified by the employees, whereas Aaron's representations to the Union's negotiator led the latter reasonably to believe that Daniel could conclude an agreement on behalf of Respondent."

In the "Remedy" section (R. 42), the Board stated as follows:

"To remedy the Section 8(a)(5) violation, the Trial Examiner recommended, in part, that the Board order the Respondent to forthwith execute the bargaining agreement reached with the Union's negotiator on about May 18, 1962. However, *more than a year has elapsed since the 1-year agreement was reached* between the negotiators for the Union and the Respondent and it is not clear whether the Union would now desire to submit this agreement to its members for ratification. Accordingly, we shall order the Respondent, upon the Union's request, *either to execute the foregoing agreement or to bargain collectively with the Union as the exclusive representative of the employees in the appropriate unit and, if an understanding is reached, to embody such understanding in a signed contract.*<sup>1</sup> *We believe that such an order, together with the "cease and desist" provisions recommended by the Trial Examiner, are adequate to remedy Respondent's violation herein.*" (Emphasis added)

---

<sup>1</sup> *Warrensburg Board & Paper Corporation*, 143 NLRB No. 47, at p. 3.

In accordance with the foregoing, the Board revised the pertinent affirmative provisions of the Trial Examiner's Recommended Order (R. 42-43) to state as follows:

"(a) Upon request by Furniture Workers Union Local 3161, United Brotherhood of Carpenters & Joiners of America, AFL-CIO *execute the agreement reached on May 18, 1962, but if no such request to execute is made, bargain* upon request with the Union as the exclusive representative of the employees in the appropriate unit." (Emphasis added)

and the recommended notice to employees (R. 43), in pertinent part, to read as follows:

"*WE WILL, upon request, execute the May 18, 1962, agreement reached by us* and the negotiator of FURNITURE WORKERS UNION LOCAL 3161, UNITED BROTHERHOOD OF CARPENTERS & JOINERS OF AMERICA, AFL-CIO; but if no request to execute is made, we will, upon request, bargain collectively with the Union as the exclusive bargaining representative of all employees in the following unit:" (Emphasis added)

Respondent promptly notified the Board of its intention to comply with the Board's order of November 15, 1963, and posted the "Notice to all Employees" as directed by said order for the required 60 days (R. 43, 34, 48). The Union, however, demanded that respondent execute the contract negotiated for a one-year term for a two-year period, namely for the period of May 1962 to May 1964 (see R. 44). This respondent refused to do as the Board's order of November 15, 1963, required no more than execution of the contract prospectively for the one-year term negotiated (*supra*, p. 8).<sup>3</sup>

---

<sup>3</sup> The Board, presumably by mistake, asserts in its brief (p. 8) that "the Company has refused to this date to sign the contract." This, of course, is contrary to fact. Respondent, after issuance of the Board's order of November 1963, was prepared at all times upon request of the Union to sign the one-year contract for the negotiated term, as directed in that order (See R. 48). It refused solely to sign the contract for longer than the negotiated one-year term, as demanded by the Union and later directed by the Board in its September 1964 order.



Ten months later, on September 14, 1964, the Board "sua sponte",<sup>4</sup> asserting that it "was administratively advised that the Charging Party and the Respondent were in dispute over the interpretation to be given to the Decision and Order" of November 15, 1963, and without any notice to respondent or opportunity to present its position on the matter, issued its so-called "Order Clarifying Decision" (R. 44-45). Said so-called clarifying order purported to note "a latent ambiguity" in the original decision and order of the Board and modified the latter in material respects. In respect to the remedy section, the so-called clarifying order deleted the third sentence (*supra*, p. 8) and substituted therefor (R. 44) the following:

"Accordingly, we shall order the Respondent, *upon the Union's request, either to execute the foregoing agreement, this agreement to be effective from May 18, 1962, to at least the next renewal date as provided therein following signature, or to bargain collectively with the Union as the exclusive representative of the employees in the appropriate unit and, if an understanding is reached, to embody such understanding in a signed contract.*" (Emphasis added)

In respect to the order, it substituted for the above quoted paragraph (a) (*supra*, p. 9) the following (R. 44):

"(a) Upon request by Furniture Workers Union Local 3161, United Brotherhood of Carpenters & Joiners of America, AFL-CIO, *execute the agreement reached on May 18, 1962, the agreement to be effective from that date to at least the next renewal date as provided therein following signature, but if no such request to execute is made, bargain upon request with the Union as the exclusive bargaining representative of all employees in the following unit:*" (Emphasis added)

---

<sup>4</sup> In its brief (p. 9), the Board seems to suggest that this was upon a "motion." There was no motion filed in respect to this matter to respondent's knowledge.

In respect to the notice to employees, it substituted for the above quoted language (*supra*, p. 9), which was in the notice duly posted by respondent in compliance with the order of November 1963, new language (R. 45) as follows:

*"WE WILL, upon request, execute the May 18, 1962, agreement reached by us and the negotiator of FURNITURE WORKERS UNION LOCAL 3161, UNITED BROTHERHOOD OF CARPENTERS & JOINERS OF AMERICA, AFL-CIO, the agreement to be effective from that date to the next renewal date as provided therein following signature, but if no request to execute is made, we will, upon request, bargain collectively with the Union as the exclusive bargaining representative of all employees in the following unit:"* (Emphasis added)

Outraged by this action, respondent promptly moved the Board for reconsideration of its so-called clarifying order (R. 46-49). In the motion, respondent, *inter alia*, challenged the Board's right to act on "administrative advice" from undisclosed sources outside the record and which was not made known to respondent; pointed out that there was no "ambiguity" in the original order which needed "clarifying," and that the September 14, 1964 order, instead, "substituted a brand new remedial order for the prior order of November 15, 1963"; called to the attention of the Board the provisions in Section 10(d) of the Act, and in Section 102.49 of its Rules and Regulations, which prohibit modification of an order, "in whole or in part," except "upon reasonable notice" (*infra*, pp. 35-36); and challenged the Board's Authority 10 months later, and after respondent had taken all steps required to comply with the original order, to change its order and impose new and different sanctions on respondent.

On November 30, 1964, the Board, without explication, "denied" the motion for reconsideration "as lacking merit" (R. 50). Thereafter, respondent notified the Regional Director that it would not comply with the new remedial directives of the so-called Order Clarifying Decision.



On about February 1, 1965, respondent petitioned the Regional Director for a new election.<sup>5</sup> The Regional Director dismissed the petition, asserting that respondent "has not yet complied with the Board's Decision and Order dated November 15, 1963, as clarified by Order dated September 14, 196[4]." Respondent's request to the Board for review of the dismissal was denied. Copy of Request for Review by the Board is attached as Appendix A hereto (*infra*, pp. 45-50).<sup>6</sup>

This is the factual situation upon which the Board seeks this Court's aid in now imposing upon respondent and its present employees—practically all of whom have been hired since the 1961 election and had no part in selecting the Union as their representative—the terms of a contract for four years which, on its face, shows was intended to be effective only for a fixed term of one year (G.C. Ex. 14). This contract, which the Board claims, over respondent's objection (R. 46-48), must be observed without exception, not only specifies controlling wages, hours and working conditions, but also requires adherence to terms that are clearly illegal. Thus, four years after the election respondent's current employees would be required to become and remain Union members and pay dues for the duration of their employment under the retroactive contract or be subject to discharge (G.C. Ex. 14, Art. III)—even though a majority of them started working for respondent after May 18, 1962, the commencement of the contract period under the Board's second order (R. 44). Also, respondent may be responsible to the Union under the Board's second order for the check off of dues for employees no longer in its employ who, after May 18, 1962, had unrevoked check off authorization cards on deposit

---

<sup>5</sup> The petition was docketed in the Los Angeles Regional Office as Case No. 21-RM-1161.

<sup>6</sup> Respondent's request to the Board that this document and the other formal papers in the representation case be incorporated in the certified record transmitted to the Court in this matter was denied.

with respondent and continued thereafter for a period to work for respondent (see G.C. Ex. 14, Art. III). In addition, respondent would, in violation of Section 302 of the Labor Management Relations Act, 1947 (29 U.S.C. Sec. 186; *infra*, pp. 51-52), unlawfully be required to deduct Union dues for the full four years from the pay of any employees with unrevoked check off cards still employed by it, and such employees would unlawfully be deprived of their right under Section 302 to an annual escape period and, instead, illegally would be bound to the check off for the four years. Thus, the Board not only disregarded respondent's contractual right to the opportunity to terminate the contract at the end of the first year, or any subsequent year (G.C. Ex. 14, Art. XII), but also disregarded the employees' protected right at law to an opportunity to terminate a check off authorization annually.

It would be illusory to assume that the Union would afford respondent's employees an opportunity to demonstrate in a vote on ratification whether, in fact, a majority of them now desire to be bound by this union-shop contract. Only members of the Union would be permitted to vote on ratification, as the Board recognized in its November 1963 decision (R. 42).<sup>7</sup>

## II. SPECIFICATION OF ERRORS

1. The Trial Examiner erred in receiving, over respondent's hearsay objection, testimony of the Union's representative regarding his conversations with a federal conciliator (Tr. 98-100), and the Trial Examiner (R. 26) and the Board (Br., pp. 7-8) erred in relying on this hearsay testimony to support their findings.

2. The Trial Examiner (R. 30-31) and the Board (R. 41) erred in finding that Daniel's October 1961 talk with

---

<sup>7</sup> In addition to those of respondent, the Union represented the employees of the members of the local Furniture Manufacturers Association (Tr. 110-111).

the employees was to undermine the Union, because not supported by the record as a whole.

3. The Trial Examiner (R. 26-30, 31) and the Board (R. 41-42) erred in finding that Daniel's agreement with the Union on May 18, 1962, was final and binding on respondent, because not supported by the record as a whole and contrary to fact and law.

4. The Trial Examiner (R. 28-30) and the Board (R. 41-42) erred in finding that Aaron was not permitted to reopen negotiations on the arbitration provisions, because not supported by the record as a whole and contrary to fact and law.

5. The Trial Examiner (R. 30, 31) and the Board (R. 41) erred in finding a "divided and fluctuating bargaining authority" between Aaron and Daniel which "lacked the bona fides" required by the Act, because not supported by the record as a whole and contrary to fact and law.

6. The Trial Examiner (R. 30, 31) and the Board (R. 41) erred in making any findings regarding the so-called "divided and fluctuating bargaining authority" between Aaron and Daniel, because not alleged in the Complaint or litigated.

7. The Trial Examiner (R. 31-32) and the Board (R. 41) erred in finding and concluding that respondent violated Sections 8(a)(5) and (1) of the Act, because such finding and conclusion are contrary to fact and law.

8. The Board (R. 42-43) erred in directing respondent to execute the agreement reached between the Union and Daniel on May 18, 1962, because such order is not justified on the record as a whole.

9. The Board (R. 44-45) erred in issuing its so-called Order Clarifying Decision, because it was not issued in compliance with the Act and the Board's Rules, it requires respondent to execute a contract for a period longer than

negotiated, it imposes illegal contractual conditions on respondent and its employees, and it deprived respondent of rights which had arisen as a result of respondent's compliance with the Board's Decision and Order issued 10 months previous.

### **III. ARGUMENT**

In brief, respondent's position here is that — (1) the Board's findings that it violated the Act are not supported by "the record considered as a whole" (Sec. 10(e) of the Act; Bd. Br., p. 27); (2) the Board improperly found that respondent's bargaining through Aaron and Daniel violated the Act for the additional reason that such was not alleged in the Complaint or litigated; (3) in any event, respondent fully complied with the Board's order of November 1963, and discharged every obligation thereunder, and the Board's subsequent order of September 1964, was a nullity and illegal, and is unenforceable; and (4) respondent is under no further obligation to recognize or bargain with the Union unless and until it currently demonstrates in an election that it represents respondent's present employees.

#### **A. THE RECORD AS A WHOLE DOES NOT SUPPORT THE BOARD'S FINDINGS**

##### **1. Daniel's Meeting With Employees**

As the Trial Examiner found (R. 30, lines 33-34), this meeting occurred shortly after Daniel's first meeting with the Union representative in October 1961, at which, among other things, the deduction of Union initiation fees and dues, and the payment of back Union dues were discussed, and respondent was given the option of keeping its present health and welfare plan or adopting the Union's (*supra*, pp. 2-3).

A fair reading of the contradictory and conflicting testimony of the four employees who testified regarding this

meeting (Tr. 13-42) discloses merely that when Daniel Newman spoke to the employees he stated that he had met with the Union and it had submitted a "fair" contract (Tr. 36, 41, 20); that if he signed the contract some employees probably would leave and that if he did not others probably would quit (Tr. 36, 20-21); that if he did sign a contract with the Union, old employees who had not paid dues since expiration of the prior contract would have to pay their back dues in two installments (Tr. 30), that new employees would have to pay their initiation fees and dues in one installment (Tr. 22, 41-42), and that it would be no use to request respondent to spread out the deductions over several pay periods because it was too great a burden on respondent to do so (Tr. 15, 22); that respondent had the choice of continuing its own health and welfare plan or adopting the Union's and it would like the employees' views as to which plan they preferred (Tr. 21); and that the "only thing" Daniel "left up to [the employees] to decide" was "which health and welfare plan [they] wanted" (Tr. 23).

Plainly this does not indicate any disregard by respondent of its bargaining obligation to the Union, as indeed the facts show did not occur. There is no evidence that respondent ever after the election challenged the Union's exclusive representative capacity, ever refused to grant the Union a union shop and check-off, or ever objected to a health and welfare plan. On the contrary, however, it is clear that the Union, under its contract demands, expected old employees to pay back dues owing from the date of the expiration of the prior contract on July 1, 1961 (Tr. 115-116) and new employees to pay both initiation fees and dues (Tr. 116), and that respondent in the past had had problems with employees who requested permission to pay their obligations to the Union in installments which respondent desired to avoid in the future (Tr. 117). Thus, it plainly was proper for Daniel Newman to advise employees that under a renewed "fair" contractual relation-



ship with the Union the employees could not expect respondent to arrange installment payments of Union obligations.

Further, it is admitted that the Union left it up to respondent to decide whether it desired to retain its existing health and welfare plan or shift to the Union's (Tr. 50, 118-119), and that agreement on this provision was reached with the Union which was entirely satisfactory (Tr. 118). Plainly, under these circumstances, no improper motive can be attributed to respondent in seeking the views of its employees on which plan they preferred—it was in the Union's interest as well as respondent's to have employee satisfaction with an agreement reached.

Moreover, it is plain that Daniel's remarks to the employees in early October 1961 were wholly unrelated to the question which arose in June and July 1962. Daniel's remarks in October related to the health and welfare plan and the payment of Union fees and dues, both of which matters had been settled to the Union's satisfaction long before the conciliation meetings (Tr. 116-118), whereas the issue in June and July related solely to arbitration. Therefore, there was no justification for the Board's action in setting aside the settlement relating to this meeting and litigating the subject in connection with an entirely unrelated matter which arose nine months later.

In any event, if the Board's findings regarding the disagreement over arbitration fall, the Board's order insofar as predicated on the October 1961 remarks of Daniel must also fall. This alleged unfair labor practice was fully remedied (R. 9-10) and the case was closed by compliance satisfactory to the Regional Director (G.C. Ex. 1(i)). The settlement was set aside and the matter reopened only because of the Union charges claiming that respondent had refused to execute the agreement reached on May 18, 1962 (R. 11-13).



## **2. Respondent's Request in June and July to Reopen Negotiations on Arbitration**

There is no disagreement as to respondent's consistent opposition to arbitration. The Union's representative admitted that both Aaron and Daniel opposed it at "all the meetings we had with the exception of the last one"—the one with the Conciliator on May 18, 1962 (Tr. 55-56). As to that meeting, the Union Representative admitted that Daniel continued then to oppose arbitration until shown Aaron's contract proposal of February 28, 1962, containing provision for such (Tr. 107, 79-80, 89-90); *supra*, pp. 4-5).

### **a. Daniel did not have authority to conclude a contract without Aaron's ratification**

The Board found that "Aaron Newman held out his son Daniel as having authority not only to negotiate, but also to conclude an agreement with the Union" (R. 41). The only foundation for this is Union Representative Taylor's testimony that Aaron, at the first bargaining conference in September, told him that Daniel "would negotiate the contract and sign it with the union" (Tr. 48). But this statement has to be interpreted in the light of the facts. In 1960, Daniel negotiated and signed the contract, but only after Aaron approved it (*supra*, p. 2). Moreover, Taylor admitted that early in the negotiations Daniel stated "that he would have to get the approval of his father before he would sign the agreement" (Tr. 61, 113, 121). Thereafter, Taylor recognized Aaron's veto authority by talking with Aaron over the telephone at Daniel's request several times during negotiations (*supra*, pp. 3-4); by meeting with Aaron pursuant to Daniel's arrangements on January 18, 1964 (*supra*, p. 4); by addressing correspondence to Aaron (*supra*, p. 4); and by demanding in his letter of March 6, 1962, that Aaron "delegate authority to someone locally to negotiate . . . and conclude our negotiations with a signed agreement" (G.C. Ex. 10). In a nutshell, as Daniel testified (Tr. 143-144, 148), Taylor fully recognized that any agreement reached with Daniel had to receive Aaron's subsequent approval.

The Board's Trial Examiner himself characterized Daniel as only a "figurehead negotiator" and stated that "actual negotiations had to be transacted with his father" (R. 30, lines 28-30) as "the real negotiator for the Respondent being, at all times, Aaron Newman (R. 30, lines 46-47). Thus, both the Union's representative and the Board's Trial Examiner recognized the fact that Daniel did not have final authority to conclude an agreement without Aaron's subsequent endorsement, contrary to the Board's finding (*supra*, p. 18).

The Trial Examiner, however, concluded that Aaron's letter to Taylor of March 14, 1962 (G.C. Ex. 11), conferred on Daniel authority which all knew he did not possess prior to that letter (see R. 27, lines 28-33). Such conclusion is contrary to the plain language of the letter. The letter merely states, "Our Mr. Dan Newman *is and has always been available to negotiate* with you. He has had ample authority *at all times*" (G.C. Ex. 11; emphasis added). This merely confirmed the "authority" Daniel had "at all times" to "negotiate"; nothing therein suggested an enlargement of Daniel's authority, or that such authority embraced the conclusion of an agreement without Aaron's ratification. To the contrary, the absence of any statement that Daniel had authority "to conclude an agreement" negates any inference that he did.

It is quite clear from Taylor's own actions and testimony after the May 18 meeting that *he* did not believe that Daniel had the authority at that meeting to conclude and sign a contract without Aaron's subsequent review and approval. Thus, first Taylor testified that, at the conclusion of the May 18 meeting with the Conciliator, Daniel said "OK. . . . Draft it up'. [referring to the contract] He would sign it" (Tr. 89). However, Taylor quickly amended this to, "He says, 'Draft it up, *we* will sign'," plainly embracing Aaron within the scope of the pronoun "we" (Tr. 89; emphasis added). Moreover, Taylor made no move after May 18 to submit the proposed contract to the mem-

bership for approval, as it seems he normally would have done had he thought a binding and unconditional agreement had been reached with Daniel. Instead, Taylor waited a week or 10 days after he had mailed the contract to Daniel before inquiring as whether it had been signed (Tr. 97). Then his comment was that he “had to have the contract signed by the company *or an indication that they were going along with that*, so that I could call the people together to have them ratify the agreement so I could sign it” (Tr. 97; emphasis added).

If Taylor truly believed he had a firm agreement, he did not require its execution before submission to the membership for approval. Even more significantly, if he truly believed that Daniel’s acceptance was final he would not have withheld action pending “an indication that [the company was] going along with” Daniel’s agreement. The explanation of Taylor’s statement is found in Daniel’s testimony that he told Taylor at the end of the May 18 meeting that he “hoped” that his father would “permit” him to sign as he “didn’t have the absolute authority to sign the contract without my father seeing it” (Tr. 141-142). Finally, unless Taylor recognized that the agreement was conditioned on Aaron’s approval, Taylor would not have let the matter drag the additional several weeks pending the meeting with Aaron on July 14 (*supra*, pp. 5-6).<sup>8</sup>

---

<sup>8</sup> The receipt of Taylor’s testimony, over respondent’s hearsay objection (Tr. 98-100), regarding his alleged conversations with the Conciliator, and its utilization to explain away this obvious inconsistency between Taylor’s actions and his subsequent testimony (R. 26; Bd. Br., pp. 7-8), plainly was prejudicial error. Moreover, the incredibility of the testimony is fully demonstrated by the facts. Thus, according to Taylor, and the findings of the Trial Examiner, the Conciliator told Taylor “I don’t think you have any problem. You meet with his father. Dan Newman said he would sign the contract if his father didn’t” (Tr. 100; R. 26). However, the facts are that Daniel did not sign the contract and Taylor did not at the July 14 meeting demand that he do so in accordance with this supposed commitment to the Conciliator (Tr. 100-101).

The Board argues (R 28; see also Br., p. 14) that, "assuming limitations on Daniel Newman's bargaining authority, the agreement reached on May 18 was concurred in by Aaron Newman" because the arbitration provisions agreed to by Daniel on May 18 had been contained in Aaron's counterproposal of February 28 which had never been withdrawn.<sup>9</sup> However, there was no need for Aaron to withdraw his February 28 proposal. Taylor, in effect, rejected the proposal in his March 6 letter (G.C. Ex. 10) and, aware of Aaron's consistent opposition to arbitration, must have anticipated the consequence of such rejection. Moreover, the agreement reached between Taylor and Daniel on May 18 materially changed Aaron's February 28 proposal on arbitration in that it subjected respondent's determinations of employee qualifications in layoffs to arbitration, whereas Aaron's proposal had excluded such determinations from arbitration (*supra*, p. 5). In addition, other changes were made in Aaron's February 28 contract proposal at the May 18 meeting (*supra*, p. 5). Thus, an entirely new agreement emerged from the May 18 meeting—not Aaron's proposal of February 28 which Taylor had previously rejected.

**b. Assuming Daniel's authority to conclude an agreement,  
Aaron's request for further negotiation on arbitration  
did not violate the Act**

For the purpose of this discussion, respondent will assume that had Taylor, acting on Daniel's acquiescence in the arbitration provisions at the May 18 meeting, submitted the agreement to the Union's members for approval and had they approved it, respondent would have been foreclosed thereafter from seeking revision of the agreement on arbitration. But these are not the facts.

---

<sup>9</sup> The Board concedes that Aaron had the right to withdraw this proposal (R. 28, lines 9-10).



Taylor was waiting for "an indication that [the company was] going along with" Daniel's agreement (Tr. 97) and, so far as the record shows (Tr. 161), Taylor has never submitted the agreement to the membership for approval. Absent such approval, there could be no agreement (Tr. 119, 148, 160) and, as Taylor admitted, he would have to "Go back into negotiation" (Tr. 161-162).

Thus, on Taylor's own testimony, no contract existed in the instant situation because Taylor had not submitted the May 18 agreement to the Union membership for approval. No mileage is available in the argument that the Union was entitled to a reasonable period in which to make such submission. Here it had two months before the meeting with Aaron on July 14 to make the submission and did not. In fact, as of the date of the hearing on December 13, 1962, five months later, it still had not done so (Tr. 161).

Thus, respondent's request for further discussion of the arbitration provisions occurred while matters were in a state of inconclusive negotiation due to the Union's reserved right to reopen negotiation in unlimited degree depending upon the wishes of the members. An employer may not be denied the right to reopen discussion on a single contract provision while the Union at the same time is reserving the right to reopen negotiations on any or all provisions.

Nor was respondent's request to reopen discussion on the arbitration clause "a blatant manifestation of bad faith," as the Board asserts (Br., p. 14). During negotiations the Union's position was that, if grievances were not to be settled by binding arbitration, the no-strike clause would have to be omitted (Tr. 59-60, 105-106). Respondent agreed with this (*ibid.*). When Aaron submitted his proposal containing arbitration on February 28, he omitted the no-strike provisions (Tr. 102-105; G.C. Ex. 7, Art. 1). Moreover, Taylor's written contract forwarded to Daniel on June 8 also omitted the no-strike clause (G.C. Ex. 14, Art. 1). Thus, respondent was in the position under the

May 18 agreement of Daniel of being subjected to the resolution of "all grievances which may arise" by arbitration, enforceable in the courts (*ibid.*, Art. IX), without the Union being bound to the results of arbitration by a no-strike clause. Under these circumstances, it plainly was not bad faith for Aaron to seek some limitation on the matters to be submitted by respondent to enforceable arbitration (see Tr. 146). Normally, a *quid-pro-quo* for arbitration is a no-strike clause; here there was none.

In addition, the situation here is distinguishable from the situation in a case like *N.L.R.B. v. Nesen*, 211 F.2d 559, 563 (C.A. 9), cert. denied 348 U.S. 820, cited by the Board (Br., p. 12), where the respondent sought to reopen negotiations on many items. Here respondent sought to reopen discussion only on arbitration—it did not seek renegotiations on union shop, check off, health and welfare plan, wages, or any other provision of the May 18 agreement.

Nor are the cases cited by the Board (Br., p. 13), where respondents without cause have refused to sign agreements reached or have repudiated signed agreements, pertinent here. Aaron assured Taylor that he had come to the meeting at 8:30 a.m. on a Saturday morning "in good faith to talk to him about this contract," but Taylor flatly refused to discuss or explore any change in the arbitration provisions (*supra*, p. 6). As the Trial Examiner himself noted, "such an exploration might possibly have had fruitful results" (R. 29, lines 48-49).

Thus, plainly, the issue is not whether respondent has refused to sign an agreement reached—respondent has not refused to sign—but whether respondent is foreclosed from reopening in good faith discussion on a single item in an agreement at a time when any or all terms of the agreement were subject to being reopened by the Union (*supra*, p. 22). This is not what the law means, we submit. See *Arkansas Louisiana Gas Co.*, 154 NLRB No. 72, 60 LRRM 1055, 1056.



**B. THE SO-CALLED DIVIDED AND FLUCTUATING  
BARGAINING AUTHORITY WAS NOT ALLEGED  
OR LITIGATED**

As stated (*supra*, p. 7), the claim that respondent violated the Act "by confronting the union in negotiations with a divided and fluctuating bargaining authority" between Aaron and Daniel was never put in issue or litigated.

The Union's charge of July 30, 1962 (R. 11) set forth the alleged refusal to bargain as follows:

"Subsequently, unfair labor practice charges were filed against the employer in case No. 21-CA-4549, which was terminated by settlement agreement wherein the employer agreed to bargain collectively with Local 3161. On or about May 18, 1962 the employer and the union arrived at a settlement of the terms of a collective bargaining agreement; that since said date the employer has refused and continues to refuse to execute said agreement or put it into effect."

The alleged refusal to bargain was repeated in the same words in the amended charges of September 26 and 28 (R. 12, 13).

The General Counsel's Consolidated Complaint, after stating the claims regarding Daniel's October 1961 meeting with the employees, alleged the refusal to bargain thusly:

"(e) Respondent negotiated in bad faith and with no intention of entering into any final or binding collective-bargaining agreement.

"(f) On or about July 14, 1962, and at all times thereafter, Respondent has refused, and continues to refuse, to sign a written agreement embodying rates of pay, wages, hours of employment, and other conditions of employment, agreed upon between Respondent and the Union."

At the opening of the hearing, the General Counsel, in colloquy with the Trial Examiner, affirmed that "the allegations are that this settlement agreement was violated and \* \* \* the violation lies in the fact that the General Counsel

alleges that the Respondent agreed on a contract at some-time subsequent to the settlement agreement, and then refused to sign it" (Tr. 11). Respondent's counsel agreed that "there are no other issues" (*ibid.*).

Moreover, the General Counsel, in his post-hearing brief to the Trial Examiner, makes clear that this question was neither raised nor litigated. In his opening statement in that brief<sup>10</sup> he stated "the General Counsel's theory" as follows:

"This brief will discuss the General Counsel's theory of the evidence and the four issues presented by the evidence. The issues are:

"(1) Whether Daniel Newman, in the exercise of either his actual or apparent authority, unqualifiedly agreed to a contract.

"(2) Whether, absent such unqualified agreement, there was a meeting between the minds of Respondent's principal, Aaron Newman, and the Union.

"(3) Whether, where ratification by the Union's membership is a condition precedent to the Union's execution of an agreement, Respondent may withdraw from the agreement prior to such ratification.

"(4) Whether Respondent unlawfully circumvented the Union by misrepresenting the Union's position to its employees and requesting its employees to approve of the contract."

In addition to the foregoing, the closing of Case No. 21-CA-4549 on April 30, 1962, pursuant to compliance "with the provisions of the Settlement Agreement" (*supra*, p. 3), discloses that the General Counsel had no intention of alleging or litigating this claim. The evidence of the "divided" authority, except for respondent's futile attempt to reopen negotiations on arbitration after May 18, 1962, all related to the period preceding March 1962 (see R. 30, lines 30-34). This was during the time when the Regional Director was being kept currently advised of the

---

<sup>10</sup> This brief, although not incorporated in the record certified to the Court, is available to the Board in its files.

negotiations. Nonetheless, the Regional Director two months later closed Case No. 21-CA-4549 on the ground that respondent had up to that time fully complied with its bargaining obligation under the Act. Had the Regional Director, or the General Counsel, regarded respondent's bargaining procedure as unlawful, Case No. 21-CA-4549 plainly would not have been closed—as it was—by compliance with the Act.

This claim was raised *sua sponte* by the Trial Examiner after the hearing in his Intermediate Report (R. 30) and without affording respondent even an opportunity to argue against the enlargement of the Complaint or the merits of his newly claimed violation. The Trial Examiner's finding in this respect was adopted by the Board without discussion (*supra*, pp. 7-8), notwithstanding respondent's exceptions on this score (*supra*, p. 7).<sup>11</sup>

The actions of the Trial Examiner, and the Board, in this respect cannot be sustained. In the first place, neither the Trial Examiner, nor the Board, has the authority to enlarge the Complaint. The authority to determine what violations to allege and what issues to litigate is vested under the Act exclusively in the General Counsel (Sec. 3(d); *infra*, p. 50). See *Times Square Stores Corp.*, 79 NLRB 361, 364-365. Clearly, the General Counsel did not believe, any more than respondent, that he was litigating a claim that respondent violated the act by the so-called divided authority of Aaron and Daniel (see *supra*, pp. 24-25).

Moreover, it is settled law that findings of the Board predicated on matters neither alleged in the Complaint nor litigated cannot be sustained. See, *N.L.R.B. v. H. E. Fletcher Co.*, 298 F.2d 594, 600 (C.A. 1); *N.L.R.B. v. Johnson*, 322 F.2d 216, 219-220 (C.A. 6); *N.L.R.B. v. Bradley Wash-fountain Co.*, 192 F.2d 144, 149 (C.A. 7). For this reason,

---

<sup>11</sup> Nor does the Board in its brief here (see Br., pp. 11-12) offer any justification for this action.

alone, the Court should deny enforcement of the Board's order insofar as it predicated on this finding.

On the merits, the absence of litigation of the issue hampers respondent's defense here. It should suffice, however, to show the lack of merit to this claim, to point to a few matters which by chance appear in the record. Thus, the negotiations in 1961 and 1962 appear to have been conducted in precisely the same manner as those culminating in the first contract in 1960 (*supra*, p. 2). Whereas Daniel did not have authority to conclude and sign an agreement without Aaron's approval (Tr. 61, 113, 121, 141-142), it is clear that short of this Daniel had responsible authority to negotiate. Thus, Union Representative Taylor admitted that on one occasion when he pressed Daniel with the question "if he signed [an agreement] would his dad live up to it," Daniel replied that "he would" but "would give him hell" (Tr. 61). Taylor also admitted that when he "discussed these various things" with Aaron, Aaron said "Well, you and Dan go on and work the thing out" (Tr. 61-62). When Taylor raised matters during negotiation on which Daniel knew Aaron had strong views, Daniel telephoned Aaron to afford Taylor an opportunity to convince Aaron otherwise (Tr. 61-63, 122-123, 128-132, 144).

Taylor's authority was similarly circumscribed. Thus, on certain matters he had to secure advance approval of the Union's "executive board" before taking a position during bargaining (see Tr. 78). In *all* matters, his agreements at the bargaining table were conditioned on subsequent approval by the members (Tr. 119-120, 161-162). As he admitted, he could not sign a contract until it was approved by them (Tr. 148, 160).

The Board (R. 41-42; Br., p. 13 fn. 5) distinguishes the limited bargaining authority of the parties on the asserted ground that respondent knew of the limitations on the Union representative's authority, whereas the Union did not know of the limitation on Daniel's authority. Such cannot

be supported on the record as a whole. Plainly, the Union's representative was fully aware that Daniel was unauthorized to sign an agreement without Aaron's approval (*supra*, pp. 18-20). But, in any event, the test of whether respondent's bargaining procedure violated the Act cannot turn on what the Union knew or did not know of the limitation on Daniel's authority, but must rest on whether the limitation on Daniel's authority under the Act was unlawful. Similar limitations customarily are imposed on bargaining representatives of unions, as they were in the instant matter.

Plainly, Daniel had the bargaining authority in the instant matter found sufficient by this Court and other courts and the Board in similar situations. See *Lloyd A. Fry Roofing Co. v. N.L.R.B.*, 216 F.2d 273, 276 (C.A. 9); *N.L.R.B. v. Almeida Bus Lines, Inc.*, 333 F.2d 729, 735 (C.A. 1); *Great Western Broadcasting Corp., d/b/a KXTV*, 139 NLRB 93, 129-130; *Midwestern Instruments, Inc.*, 133 NLRB 1132, 1139-1140; *McLean-Arkansas Lumber Co.*, 109 NLRB 1022, 1038.

Moreover, the facts are that with this so-called divided authority the parties nonetheless in 1960 reached complete agreement, and in 1961-1962 reached complete agreement on all matters except the arbitration provision, which Taylor refused to discuss with Aaron on July 14 (*supra*, p. 6).

As the Second Circuit, in *N.L.R.B. v. Fitzgerald Mills Corp.*, 313 F.2d 260, 267, cited by the Board (Br., p. 12), stated, "If in other respects good faith is found it is not enough to establish an unfair labor practice solely that the representative of the Company was not empowered to enter into a binding agreement." In that case, and in *N.L.R.B. v. Hibbard*, 273 F.2d 565, 568 (C.A. 7), also cited by the Board (Br., p. 12), there was other significant evidence of the respondent's concurrent refusal to bargain in good faith. In the instant matter, the only evidence of a claimed concurrent refusal to bargain is Aaron's attempt to reopen



negotiations on the single subject—arbitration. This, as shown above, did not violate the Act.

### C. THE BOARD'S ORDERS

A reading of the Board's brief (pp. 16-24) leads respondent to the conclusion that the Board, as of this late date, still does not comprehend respondent's objections to the Board's so-called "Order Clarifying Decision" of September 1964 (R. 44-45), notwithstanding respondent's motion for reconsideration (R. 46-48). Respondent does not contest the Board's authority "to order an employer presently to execute a contract which he wrongfully refused to execute in the past" (Br., p. 16), even when "the agreed-upon contract \* \* \* expired \* \* \* after the issuance of a Board order" (Br., p. 19-20); nor the Board's authority to afford the Union an option between execution of such a contract or further bargaining (Br., p. 17). Such an order may reasonably be deemed necessary to "effectuate the policies of this Act" (Sec. 10(c) of the Act).

In fact, recognizing the probable propriety of the Board's order of November 15, 1963, respondent waived its right to contest the Board's findings in an enforcement proceeding and promptly and fully complied with the provisions of the order, including posting the directed "Notice to All Employees" for the required 60 days (*supra*, p. 9).

What respondent does object to is the Board's subsequent unlawful modification in its so-called "Order Clarifying Decision" of September 1964, of its order of November 1963. This subsequent order was issued on "administrative" advice undisclosed to respondent to correct a claimed "ambiguity" which did not exist, and without the required "notice" to respondent or opportunity to be heard. It unlawfully saddles respondent and its employees with a contract which has a term of three or more years (now four or more years), when respondent had agreed to a contract



for a term of only one year,<sup>12</sup> and which, under the Board's order, imposes illegal conditions (*supra*, pp. 12-13).

Moreover, the new order was issued months after respondent had fully complied with the order of November 1963, had advised the Regional Director in writing of its intention to do so, and had posted the ordered "Notice to All Employees" for the required 60 days (R. 48, 33-34, 43), and respondent reasonably had assumed that the case was at an end.

Under these circumstances, it is understandable why respondent felt "outraged" when the Board 10 months later, in September 1964, issued its deceptively entitled "Order Clarifying Decision," substituting a brand new remedial order for the prior order of November 1963 (R. 44-45). Plainly this so-called clarifying order exceeded the Board's authority and was a nullity, and respondent properly refused to recognize its validity.

#### **1. The September 1964 Order Did Not Clarify. It Modified and Set Aside the November 1963 Decision and Order**

The Board, in the September 1964 order, professed to see a "latent ambiguity in the language" of the November 1963 decision and order, and asserted to "clarify such language" by its September 1964 order (R. 44). However, there was no ambiguity, latent or otherwise. Nor did the September 1964 order merely clarify. Instead, it modified and set aside, in part, the prior decision and order and substituted a brand new remedy, imposing therein new and additional sanctions on respondent.

In its remedy section, the Board's decision of November 1963, in clear and unequivocal terms, stated that because

---

<sup>12</sup> Although the contract that Union Representative Taylor testified was "the document that [he] sent to" respondent on June 8, 1962 (Tr. 93; G.C. Ex. 14), contains neither the month nor the day of execution or termination (G.C. Ex. 14, pp. 1, 8-9), Taylor testified that the agreement was for a one-year contract (Tr. 92).

“more than a year has elapsed since the *1-year agreement* was reached,” and the Union may not “now desire to submit *this agreement* to its members for ratification,” respondent would be required, at the Union’s option, “either to *execute the foregoing agreement* or to bargain” (*supra*, p. 8; R. 42; emphasis added). The words “execute the foregoing agreement” present no ambiguity. In context, they could only mean—sign “the 1-year agreement” reached for the prospective term of 1-year after signing.

This meaning is also made clear in the concern demonstrated by the Board that the Union may not “now desire to submit this [1-year] agreement to its members for ratification.” Nothing in the remedy section of the November 1963 decision remotely suggests that respondent was being required “to execute” a contract for a 2-year or more term, or that the members would have opportunity to vote on ratification of this contract for a 2-year or more term. As to this, such a suggestion is completely negated by the Board’s comment that “more than a year has elapsed since the 1-year agreement was reached.”

Nor is there anything in the Board’s November 1963 order from which an implication of ambiguity may be drawn. The affirmative provisions merely direct respondent, upon request of the Union, to “execute the agreement reached on May 18, 1962” (*supra*, p. 8; R. 43). As shown, the Board in the remedy section recognized that the agreement which had been reached on May 18, 1962, was for a “1-year” contract (*supra*). Likewise, in the notice ordered posted respondent was directed merely to advise the employees that, upon request of the Union, it would “execute the May 18, 1962 agreement” (*supra*, p. 8; R. 43).

Thus, there is not even the slightest implication in the Board’s decision and order of November 1963, either in the remedy section, or the affirmative directives, or the ordered notice to employees, that respondent was being directed to execute the 1-year agreement reached on May 18, 1962 for

a term of 2 or more years retroactive to May 18, 1962. If this were the intent of the Board there surely would have been at least some slight suggestion of this intent in its November 1963 decision and order. *The Board is not a novice in the field of devising remedies and issuing remedial orders. Phelps Dodge Corp. v. N.L.R.B.*, 313 U.S. 177, 198-200. It has been in that business now for 30 years.

That the November 1963 decision and order was "ambiguous," or required clarification, also is completely refuted by the fact that the remedy directed—execute the contract for the agreed term—was the customary remedy for violations like that found here. See *New England Die Casting Co.*, 116 NLRB 1, 5. As of the time of the Board's decision and order of November 1963, the Board had never directed a respondent in a similar situation to execute a contract for a term longer than the one on which agreement had been reached. See *Warrensburg Board & Paper Corp.*, 143 NLRB 398, 399; *Wait, Inc.*, 132 NLRB 1338, 1339; *Sheet Metal Workers Union (Inland Steel Products Co.)*, 120 NLRB 1678, 1679.

The Board has not, and cannot, cite a single case in which it, on or before November 15, 1963, the date of its original decision and order herein, or prior to respondent's compliance therewith, ever directed a respondent to execute a contract and give effect to it for a term longer than the term specified in the agreed contract. Nor has, nor can, the Board cited a single case in which an order like its November 1963 order has been so construed by the courts.

In this connection, the Board's assertion (Br., p. 20) that even after "the parties negotiated a new contract" in *Henry I. Siegel*, 147 NLRB 594, enf'd 340 F.2d 309 (C.A. 2), "the Board ordered incorporation in a written and signed document" of "a certain provision" the respondent had "wrongfully refused to incorporate" in a preceding contract, is without foundation. In that case all the Board did was to order the respondent *not to refuse in the future*

to incorporate such a provision in a contract were agreement reached on the provision's terms (see 147 NLRB, at p. 596; 340 F.2d, at p. 310). In any event, this decision of the Board was issued seven months after the Board's decision of November 1963 was issued in this case.

Smimilarly, the Board's assertion in its brief (p. 24, fn. 8) that the Board's "intention" in its November 1963 decision was to require respondent to execute the 1-year agreement reached for a two or more year term is "revealed" by the Board's citation in that decision of the *Warrensburg* case, is without support. A mere glance at the remedy section in the Board's decision of November 1963 (*supra*, p. 8; R. 42), discloses that the *Warrensburg* case was there cited solely in support of the option given the Union to demand either execution of the agreement reached or further bargaining. But what *is* "revealing" in the *Warrensburg* decision is that the Board there clearly disclosed that its intention was not to require a respondent to execute a contract for a term longer than that which had been negotiated. Noting that the respondent there had put the terms of the two-year contract into effect, the Board even refused to order the respondent, upon request, to execute the contract prospectively for its full two-year term saying, to do so, because of the respondent's compliance with it up to that time, "would unduly *extend* the contract beyond the term originally agreed upon" (143 NLRB, at p. 399; emphasis added).

It is also apparent on its face that the September 1964 order did not merely clarify the original decision and order. If this were the intention, the September 1964 document, whatever it might have been called, would simply have have said, in substance, that the Board construes the directive of the original order, namely, to "execute" the agreement reached on May 18, 1962,<sup>13</sup> to

---

<sup>13</sup> This is the directive, each time set forth in slightly different words, contained in "The Remedy," "Order," and "Notice" provisions of the November 1963 decision and order (R. 42-43).



require execution of the May 18, 1962 agreement effective from May 18, 1962, to at least the next renewal date as provided therein following signature. Presumably the Board would have cited authority for this construction of its order, and the issue here, or in a later proceeding, would be whether this was a reasonable construction of the words used. Under this procedure there would have been no requirement to re-post the notices to employees already posted or to post new notices. Instead, the Board deliberately set aside and modified its November 1963 decision and order by imposing new and different obligations on respondent, including the obligation to post a new notice after it had complied fully with the notice posting requirement of the original order. Having done this, the Board here argues at length that the September 1964 order should be enforced as a proper exercise of its "broad discretionary power" (Br., pp. 16-23), and advances only brief and spurious argument that it should be enforced as a proper *clarification* of the language of the November 1963 decision and order (Br., pp., 23-24).

The Board, in its brief (p. 22), in fact confesses that the Board in its September 1964 order modified its November 1963 decision and order by "choosing the remedy which more adequately repaired the unlawful damage," and then argues (Br., p. 23) that what was "modified" was "not the order but the cost of compliance therewith." But, in the Board's words (Br., p. 23), "this is sheer semantics." The Act and the Board's Rules prohibit the modification of "any finding or order" "in whole or in part," except "upon reasonable notice," and do not distinguish between modifications which merely increase "the cost of compliance" and other modifications (*infra*, pp. 35-36).

Respondent does not contend that the Board is without authority to remedy a situation like this because the "Board's processes have not been completed before" the term of the contract agreed to has expired (see Bd. Br., p. 20). Rather, respondent's complaint is that after the Board ordered the remedy customary in such a situation,

and respondent had fully complied with it, the Board, without regard to the limitations on its authority under the statute and its own Rules and Regulations, unlawfully devised and promulgated a new and different remedy, which, in addition, was illegal.

## **2. The Board's Modification of Its November 1963 Decision and Order Exceeded Its Authority and Was a Nullity**

In the first place, the Board admitted that, in changing its decision and order of November 1963 by its "Order Clarifying Decision" of September 1964, it acted on so-called administrative advice. Respondent was neither informed of the nature of this administrative advice, nor given an opportunity to refute it or correct it. Plainly, Board action on this kind of advice, without disclosure to the parties and opportunity to counter is contrary to the provisions of Section 10 of the Act, which require cases to be decided on the record. Moreover, it is contrary to the basic concepts of due process which require that persons be apprised of the evidence against them and then be afforded opportunity to refute it.

Moreover, the Board's issuance of its second order, setting aside and modifying its original decision and order without notice to respondent or opportunity to be heard, clearly was in excess of its statutory authority and in violation of its own Rules and Regulations and, therefore, a nullity. Section 10(d) of the Act specifies that:

"(d) Until the record in a case shall have been filed in a court, as hereinafter provided, the Board may at any time, upon reasonable notice and in such manner as it shall deem proper, modify or set aside, in whole or in part, any finding or order made or issued by it."

Section 102.49 of the Board's Rules and Regulations, Series 8, as amended, in effect at the time of issuance of the September 1964 so-called clarifying order, provides, in pertinent part, that—



“Sec. 102.49 *Modification or setting aside of order of Board before record filed in court; action thereafter.* — . . . until a transcript of the record in a case shall have been filed in a court, within the meaning of Section 10 of the act, the Board may at any time upon reasonable notice modify or set aside, in whole or in part, any finding of fact, conclusions of law, or order made or issued by it. . . .”

Thus, both the Act itself, and the Board's own Rules, condition the Board's authority to “modify or set aside, in whole or in part, any finding . . . or order,” “*upon reasonable notice*” (emphasis added). This means notice in advance, as the Board concedes (Br., p. 24).

It is settled that when a “statute provides for notice and hearing, . . . an award made *without proper notice*, or suitable opportunity to be heard, may be attacked and set aside as without validity.” *Crowell v. Benson*, 285 U.S. 22, 47-48 (emphasis added). See also *American Power & Light Co. v. S.E.C.*, 329 U.S. 90, 108.

It is likewise clear that the Board was bound by its own Rules to give respondent “reasonable notice” before modifying or setting aside its original order of November 1963. The disregard of these Rules also nullifies the Board's action here. See *Service v. Dulles*, 354 U.S. 363, 372-373; *U.S. ex rel. Accardi v. Shaughnessy*, 347 U.S. 260, 265-266.

The Board in its brief concedes (pp. 23-24) that “if the Board had originally intended to require the contract to be effective only in the period following its execution and then issued a subsequent order requiring the effective period to begin as of respondent's refusal to sign, this *would* constitute a modification of the original order and respondent would be entitled to reasonable notice prior thereto. Section 10(d) of the Act.” *This is, in fact, what the Board has done and it has not cited a single case which would even suggest the contrary.*

If the Board could do so it would not have to descend in its brief (p. 24) to arguing that “the Board itself recited

that its September 1964 order was merely 'to clarify,'" and that "Respondent's argument to the contrary . . . was presented to the Board . . . and was rejected." An administrative agency plainly cannot legalize unlawful procedure by itself affixing a lawful label to it, or by cavalierly rejecting "argument to the contrary."

### **3. Respondent Is Prejudiced by the Board's September 1964 Order**

The Board seems to argue that respondent is not prejudiced by the Board's illegal modification and setting aside of its November 1963 decision and order and, therefore, is entitled to no relief (1) because respondent had agreed to the annual renewal of the 1-year agreement reached on May 18, 1962, absent timely notice of termination (Br., pp. 17-18), and (2) because, the Board asserts, respondent has not "changed its position in reliance upon, the Board's original order" and, therefore, the Board argues "This case is no different than it would have been had no Board order issued at all until September 1964" (Br., pp. 22-23).

However, such a contention is irrelevant. An order made without required notice is invalid (*supra*, p. 36). Moreover, a "denial of [a statutory] right must be deemed to result in injury." *Leedom v. Kyne*, 249 F.2d 490, 491 (C.A.D.C.), *aff'd* 358 U.S. 890. In addition, respondent in fact is prejudiced by the September 1964 order, and did change its position predicated on the November 1963 order.

Thus, respondent did agree that the 1-year contract would automatically renew itself year after year unless timely notice of termination were given (G.C. Ex. 14, p. 8). But the agreement reserved to respondent, as well as to the Union, the right to terminate the agreement at the end of the first and each successive year, if it desired. And this right was preserved in respondent under the Board's decision and order of November 1963. However, in the September 1964 order the Board directed respondent to executive the contract effective from May 18, 1962, to "at

least the next renewal date" (R. 44), without preserving in respondent the right, retrospectively, to terminate the contract as of the end of any preceding contract year. Thus, the Board, by its second order, deprived respondent of its contractual right to terminate the 1-year agreement on any anniversary date and forced on respondent a contract term of three or more years, now four or more years, when respondent had agreed only to a contract term of one year.

The Board's argument (Br., pp. 17-18) to the effect that respondent is at fault for not giving timely notice of termination—"without prejudice, of course, to its allegation that no contract had ever become binding," or that a "different problem might be presented" had it done so, is incomprehensible. It was respondent's belief that no final agreement had been reached in 1962. Therefore, there was no occasion in 1963 to give notice of termination; one does not terminate a non-existing contract. But had respondent done so, the gesture would have been futile. The Board would not concede that its authority to remedy a situation by ordering execution of an agreed contract could be thwarted by such a transparent maneuver. After issuance of the Board's order of November 1963, there was no occasion for respondent to give notice of termination either. Under that order a contract could come into existence only if the Union then agreed to "the 1-year agreement" (R. 42-43). The Union did not, and sought an agreement for a different term (*supra*, p. 9). Surely the Board is not suggesting that after issuance of the Board's second order in September 1964, respondent could have escaped any lawful consequences of that order by giving timely notice of termination prior to May of this year.

The other contention of the Board (Br., pp. 22-23), that respondent has not changed its position in reliance upon the November 1963 order and that the situation is no different than it would have been had no order issued at

all until September 1964, is equally without substance. It is undenied that respondent fully complied with the order of November 1963, posted the "Notice to All Employees" required by the order, and notified the Regional Director of such compliance (*supra*, p. 9). Thereafter, the Union neither requested respondent to execute the 1-year contract as required by the Board's order, nor requested respondent to bargain for a different contract (*supra*, p. 9).

In substance, respondent fully purged itself of any unfair labor practice it may have previously committed by voluntary and full compliance with the order of November 1963. Until issuance of the *sua sponte* second order in September 1964, no representative of the Board, to respondent's knowledge, questioned respondent's compliance. But by that time more than a reasonable period of time had elapsed since compliance and respondent was no longer required to recognize or bargain with the Union in view of the passage of time since the 1961 election during which period there had been an almost complete turnover of employees in the bargaining unit (see *infra*, pp. 47-50). See *Squirrel Brand Co.*, 104 NLRB 289, 290-291; *Northwest Photo Engraving Co.*, 106 NLRB 1067, 1068-1069; *Lansenberg Hat Co.*, 116 NLRB 198, 199.

The situation in this regard would perhaps be different had respondent been on timely notice of a contemplated revision of the Board's order. Presumably, this would have been by motion of the Union, or the General Counsel, formally requesting clarification or revision.<sup>14</sup> But no such

---

<sup>14</sup> The Board (Br., pp. 22-23) suggests that respondent should have filed such a motion. However, respondent had no cause to do so. From the plain meaning of the language of the November 1963 decision and order, and knowledge of the manner in which similar orders in the past had been interpreted, respondent knew that all required was that it agree to execute the agreement prospectively for its term. To respondent's knowledge, only the Union contended otherwise, and the burden was on it, not respondent, to seek support for its strained interpretation (*supra*, p. 38-39).



action was taken by the Union, or the General Counsel. Instead, the Union stood fast on its sole demand that respondent execute the agreement for a term effective on its face from May 1962 to May 1964, and let time run against it. What the Board seeks here is to "exculpate" the Union for its unreasonable position and "deprive the . . . employees" (Br., p. 22) of their right currently to express their desires regarding representation by the Union.<sup>15</sup> This cannot be sustained as a proper exercise of "the broad discretionary power accorded the Board" (Bd. Br., p. 16).

#### **4. The Board's September 1964 Order Requires Respondent and Its Employees to Submit to Illegal Contract Provisions**

As noted (*supra*, pp. 12-13), the agreement which the Board asserts, over respondent's objection, must be observed without exception retrospectively to May 18, 1962, and prospectively to the next renewal date after signature, contains union shop and check off provisions. Thus, more than four years after respondent's then employees voted for the Union, respondent's current employees would be required to become and remain Union members and pay dues for the duration of their employment under the retrospective and prospective contract or be subject to dis-

---

<sup>15</sup> The Board, in this connection, also asserts that respondent did not "offer to put the bargained-for contract terms into effect pending resolution of its dispute over the interpretation of the Board's order" (Br., pp. 22-23). This is irrelevant. Respondent was not requested to do so by the Union, or the Board, and absent such a request would not have dared to even contemplate such unilateral action. The Board's order was clear and concise. The option was the Union's not respondent's, and the Union was fully aware of respondent's preparedness to honor the Union's proper exercise of the option. The Union could have requested respondent to sign the agreement in accordance with its interpretation of the November 1963 decision and order as providing for a prospective term of 1-year, while seeking Board clarification as to whether the decision and order, as the Union contended, also required execution of the agreement retroactive to May 18, 1962. Instead, the Union chose not to do so and must be required to assume the consequences of its inaction.

charge—even though a majority of them had no voice in the selection of the Union and started working for respondent after May 18, 1962, the commencement of the contract period under the Board's September 1964 order (*supra*, pp. 10-11).

However, the Act conditions the legality of such an agreement upon the Union being the "majority" representative of the employees as provided in Section 9(a) (*infra*, p. 51) when "such agreement" is "made" (Sec. 8(a) (3); *infra*, p. 51). While it may be assumed that the Union was the statutory representative of respondent's employees when agreement to the union shop provision in the "1-year" contract was reached on May 18, 1962, there is no basis for assuming it remained such over two years later when the Board issued its September 1964 order for the first time imposing on respondent and its employees a contract for a term of three or more years (which respondent never "made"), or that it remains such now when the Board is seeking through this Court to impose on respondent and its employees a contract having a term of four or more years. To the contrary, the only evidence is that the Union currently represents substantially none of respondent's employees due to the turn-over of personnel during the intervening years (*infra*, p. 47).

This case does not pose the question of whether *an employer* should be required, after the Union has lost its majority, nonetheless to purge its prior unlawful conduct by recognizing and bargaining with the Union. Rather, the question here is whether the Board may require *employees*, a majority of whom never had opportunity to vote for or against the Union and may not desire the Union, nonetheless to become members of, or at least pay dues to, the Union for what *now* would be a four year period even though respondent never agreed to a contract for more than a "1-year" term. It is submitted that the Board's September 1964 order in this respect is clearly illegal under the Act.



In addition, under the check off provisions of the four-year contract imposed by the Board, respondent would be liable to the Union for the check off of dues for employees no longer in its employ, who, after May 18, 1962, had unrevoked check off authorization cards on deposit with respondent, for the duration of their continued employment thereafter with respondent (*supra*, pp. 12-13). It also would be required to deduct dues for the full four years from the pay of any employees with unrevoked check off cards on deposit who are still employed by it (*supra*, p. 13). However, Section 302 of the Labor Management Relations Act, 1947 (*infra*, pp. 51-52), specifies that it is unlawful to enforce check off authorizations "for a period of more than one year, or beyond the termination date of the applicable collective agreement, *whichever occurs sooner*" (emphasis added).

Both of these illegal consequences of the Board's order of September 1964 were called to the Board's attention in respondent's motion for reconsideration (R. 48) but, like respondent's other objections and exceptions in this matter, were totally disregarded.

For this additional reason the Court should deny enforcement of the Board's September 1964 order.

**D. RESPONDENT IS UNDER NO LAWFUL OBLIGATION TO  
FURTHER RECOGNIZE OR BARGAIN WITH THE  
UNION PENDING AN ELECTION**

Assuming that the Board's decision and order of November 1963 is supported by the record, there is nonetheless no basis for requiring respondent now to recognize or bargain with the Union, or sign any contract with it, absent a current demonstration of its majority status in a Board election.

As shown above (p. 9), and more fully set forth in respondent's request to the Board for review of the Regional Director's dismissal of respondent's election petition (*infra*, pp. 45-46), respondent fully complied with the Board's order of November 1963 and discharged its

obligation to the Union thereunder. More than a "reasonable period" elapsed thereafter before issuance of the Board's *sua sponte* order of September 1964, by which time respondent was no longer required to recognize the Union whose majority status it in good faith doubted (*supra*, p. 39). In any event, the September 1964 order was a nullity and could impose no obligation on respondent to continue to recognize or bargain with the Union.

Respondent thereafter duly filed with the Board a petition for an election predicated on its good faith belief that the Union no longer represented its employees due to the almost complete turnover of personnel during the intervening years (*supra*, p. 12; *infra*, p. 47). The Board refused, improperly, to conduct an election.

Under these circumstances, respondent clearly is under no further duty to recognize or bargain with the Union, unless at some future date it demonstrates in an election that it does in fact represent the employees. This Court, it is submitted, should issue no order which would require otherwise.

#### IV. CONCLUSION

Wherefore, the Court should deny the Board's petition for enforcement in its entirety, or at least deny enforcement of the Board's invalid order of September 1964 and condition any enforcement decree on the Union demonstrating its current right to represent the employees is an election.

Respectfully submitted,

JOSEPH C. WELLS

WINTHROP A. JOHNS

1120 Tower Building

Washington, D.C. 20005

*Attorneys for Respondent*

*Of Counsel:*

REILLY AND WELLS

1120 Tower Building

Washington, D.C. 20005

**CERTIFICATION**

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

/s/ WINTHROP A. JOHNS  
WINTHROP A. JOHNS  
*Attorney for Respondent*

September 17, 1965

**APPENDIX A**

UNITED STATES OF AMERICA  
BEFORE THE NATIONAL LABOR RELATIONS BOARD  
COLONY FURNITURE COMPANY  
and  
FURNITURE WORKERS UNION, LOCAL 3161

CASE No. 21-RM-1161

**Request For Review**

Colony Furniture Company (herein called Colony), pursuant to Section 102.67 of the Board's Rules and Regulations, herewith requests review of the Regional Director's dismissal of the RM petition filed herein by Colony. The dismissal letter, served by mail, is dated February 17, 1965. Review is requested on the grounds that (1) a substantial question of law or policy is raised because of a departure from officially reported Board precedents, and (2) the Regional Director's decision on a substantial factual issue is clearly erroneous on the record and such error affects the rights of Colony.

**I. The Facts**

On August 25, 1961 (Case No. 21-RM-741), the Regional Director conducted an election among Colony's production and maintenance employees at its plant at 1125 Lanzit Avenue, Los Angeles, California, as a result of which Furniture Workers Union, Local 3161 (herein called the Union), was certified, on September 6, 1961, as the employees' bargaining representative.

On November 15, 1963, the Board issued a decision and order in Case Nos. 21-CA-4549, 4906, directing Colony, upon request, to execute an agreement found by the Board to have been reached on May 18, 1962, or, if the Union so requested, to bargain with the Union over a new contract. On December 3, 1963, the Regional Director was advised of Colony's intention to comply with said decision and

order and of the posting of the required notices to employees. The notices remained posted for the required 60 days. Said agreement found to have been reached by the parties on May 18, 1962, provided for *a contract term of one year*.

Although fully advised of Colony's intention to comply with the said decision and order of the Board of November 15, 1963, the Union never requested Colony to execute said agreement *for a term of one year*, or to bargain for a new contract. Instead, the Union on November 27, 1963, and thereafter, demanded that Colony execute said agreement *for a term of two years* retroactive to May 18, 1962. This Colony properly refused to do, but reiterated its willingness to comply with the Board's said order as issued.

On September 14, 1964, without prior notice to Colony, and opportunity to be heard on the matter, the Board issued a so-called "Order Clarifying Decision," directing Colony to execute said agreement for, at least, *a term of three years*, retroactive to May 18, 1962, and effective to, at least May 17, 1965. Believing that this so-called "Order Clarifying Decision" was, instead, a modification of the November 15, 1963, decision and order, and that the Board exceeded its statutory authority, and violated its own Rules, in issuing it, and further believing that the action exceeded the Board's remedial powers, Colony timely moved on October 1, 1964, for reconsideration of the so-called clarifying order.

On November 30, 1964, the Board denied Colony's motion for reconsideration.

On December 31, 1964, the Regional Office was notified that Colony did not intend to comply with the Board's so-called clarifying order, as follows:

"I have been in touch with my clients and while they had previously advised you of their intention to comply with the original decision and order of the Board of November 15, 1963, they are outraged by the Board's

decision and amended order of September 14, 1964 and have no intention of complying with that unless the court of appeals directs them to do so."

By letter dated February 1, 1965, Colony forwarded the petition in the instant matter to the Regional Director for processing to a new election in the bargaining unit. In the letter, Colony explained that during the three-and-a-half years since the August 1961 election "there has been an almost complete turnover of the personnel in the unit" and for this reason it "doubts that the Union . . . at the present time represents any of the employees in the unit." Colony also reminded the Regional Director that more than a year had elapsed since he had been notified of Colony's "intention to comply with the Board's decision and order" of November 15, 1963, and "since compliance therewith." Accordingly, Colony stated, it believed "the employees presently in this bargaining unit are entitled to express *their* wishes as to whether or not they desire to be represented by the Union."

By letter dated February 17, 1965, the Regional Director dismissed Colony's petition for an election stating, *inter alia*, that—

"It does not appear that further proceedings are warranted by reason of the Board's Order in Cases Nos. 21-CA-4549 and 21-CA-4906, requiring the Employer to bargain collectively with Furniture Workers Union Local 3161, United Brotherhood of Carpenters and Joiners of American, AFL-CIO, as the representative of the employees in the instant case. Our records show that this case has not been closed on compliance. I am, therefore, dismissing the petition in this matter."

## II. Argument

The Regional Director's dismissal of Colony's petition is erroneous in fact and law.

It has been the Board's uniform policy over the years, absent a contract bar, to conduct a new election in a bar-



gaining unit after a year where an employer, as here, has a good faith doubt as to the union's current majority status. See, *e.g.*, *Kimberly-Clark Corp.*, 61 NLRB 90, 92-93 and cases cited; *Celanese Corporation of America*, 95 NLRB 664, 671-674.

Colony plainly has just cause for its good faith doubt here three-and-a-half years later due to the almost complete turnover in personnel, and has backed up that doubt with its petition for an election. See *Celanese Corporation of America, supra*, at p. 674. There is no contract with the Union, or any union, which would bar an election.

When there is an intervening Board order to bargain, or a court decree enforcing such, the certification period is extended *only* until there has been compliance with the order or the decree. *Squirrel Brand Co.*, 104 NLRB 289, 290-291; *Northwest Photo Engraving Co.*, 106 NLRB 1067, 1068; *Lansenberg Hat Co.*, 116 NLRB 198, 199; *Armco Drainage & Metal Products Co.*, 116 NLRB 1260, 1261-1262.

In the instant matter, Colony was in full compliance with the decision and order of the Board of November 15, 1963, commencing in December 1963, and *Colony's compliance was not challenged by the Regional Director or a petition to enforce*. Instead, 10 months later, the Board on September 14, 1964, *sua sponte*, on so-called administrative advice, issued its so-called clarifying order.

Colony promptly challenged the Board's right lawfully to issue the so-called clarifying order. When the Board reaffirmed its improper clarifying order, Colony notified the Regional Director that it did not intend to comply with it unless the Court of Appeals directed it to do so.

Thus, Colony's compliance with the Board's decision and order of November 15, 1963, was unchallenged for a period of 10 months, and thereafter may be improperly challenged only on the basis of the Board's unlawful order of Septem-

ber 14, 1964. Under these circumstances, there is no valid basis for denying a new election on the ground that the Regional Office's file "has not been closed on compliance." There is no noncompliance with the law here.

There never has been an issue over bargaining with the Union pursuant to the 1961 certification—Colony at all times, up to the filing of the petition in the instant matter, has recognized the Union as the representative of the employees in the unit and has been willing to bargain with it as such. The question before the Board in the complaint case was whether Colony had reached agreement with the Union on May 18, 1962, on terms of a one-year contract. When the Board on November 15, 1963, issued its decision and order, finding that Colony had so agreed and directing it to execute the agreement or bargain for a new one, at the Union's choice, Colony promptly expressed its intention to comply. Since then, and up to the filing of the petition herein, the only disagreement, first with the Union and then with the Board, has been whether an alleged agreed-upon one-year contract should be extended, unlawfully, into a two or three-year contract. In other words, at no time since the certification has there been a refusal by Colony to discharge its obligation under the law to recognize and bargain with the Union. At all times since the Board's order of November 15, 1963, and up to the filing of the petition here, the *only* disagreement has related to the term of a contract—an issue which in no respect impugns Colony's good faith in challenging the Union's current majority in the instant matter.

Plainly, in equity and justice, a new election should be held in the instant matter before Colony should be required to bind its current employees to the terms of a contract, including union shop and check-off provisions, negotiated three years ago by a union selected by a different complement of employees. The Board has this authority, and the failure to exercise it under the circumstances here would, we submit, be an abuse. See *Brooks v. N.L.R.B.*, 348 U.S. 96,

103; *McLean v. N.L.R.B.*, 333 F.2d 84, 88-89 (C.A. 6); *N.L.R.B. v. Warrensburg Board & Paper Corp.*, 58 LRRM 2145, 2148 (C.A. 2).

### III. Conclusion

For the foregoing reasons, the Board should grant this request for review, reverse the Regional Director's dismissal of the petition, and remand the case to the Regional Director with instructions to conduct the election as requested in the petition.

\* \* \* \* \*

Dated February 24, 1965

### APPENDIX B

NATIONAL LABOR RELATIONS ACT, AS  
AMENDED (29 U.S.C., SEC. 151 *et seq.*):

\* \* \* \* \*

SEC. 3. (d) There shall be a General Counsel of the Board who shall be appointed by the President, by and with the advice and consent of the Senate, for a term of four years. The General Counsel of the Board shall exercise general supervision over all attorneys employed by the Board (other than trial examiners and legal assistants to Board members) and over the officers and employees in the regional offices. He shall have final authority, on behalf of the Board, in respect of the investigation of charges and issuance of complaints under section 10, and in respect of the prosecution of such complaints before the Board, and shall have such other duties as the Board may prescribe or as may be provided by law. . . .

\* \* \* \* \*

SEC. 8. (a) It shall be an unfair labor practice for an employer—

\* \* \* \* \*

(3) by discrimination in regard to hire or tenure of employment or any term or condition of employment

to encourage or discourage membership in any labor organization: Provided, That nothing in this Act, or in any other statute of the United States, shall preclude an employer from making an agreement with a labor organization (not established, maintained, or assisted by any action defined in section 8 (a) of this Act as an unfair labor practice) to require as a condition of employment membership therein on or after the thirtieth day following the beginning of such employment or the effective date of such agreement, whichever is the later, (i) if such labor organization is the representative of the employees as provided in section 9 (a), in the appropriate collective-bargaining unit covered by such agreement when made. . . .

\* \* \* \* \*

SEC. 9. (a) Representatives designated or selected for the purposes of collective bargaining by the majority of the employees in a unit appropriate for such purposes, shall be the exclusive representatives of all the employees in such unit for the purposes of collective bargaining in respect to rates of pay, wages, hours of employment, or other conditions of employment: Provided, That any individual employee or a group of employees shall have the right at any time to present grievances to their employer and to have such grievances adjusted, without the intervention of the bargaining representative, as long as the adjustment is not inconsistent with the terms of a collective-bargaining contract or agreement then in effect: Provided further, That the bargaining representative has been given opportunity to be present at such adjustment.

\* \* \* \* \*

LABOR MANAGEMENT RELATIONS ACT, AS  
AMENDED (29 U.S.C., SEC. 186):

\* \* \* \* \*

RESTRICTIONS ON PAYMENTS TO EMPLOYEE  
REPRESENTATIVES

SEC. 302. (a) It shall be unlawful for any employer . . . to pay, lend, or deliver, or agree to pay, lend, or deliver, any money or other thing of value—

\* \* \* \* \*

(2) to any labor organization, or any officer or employee thereof, which represents, seeks to represent, or would admit to membership, any of the employees of such employer who are employed in an industry affecting commerce; or

\* \* \* \* \*

(c) The provisions of this section shall not be applicable . . . (4) with respect to money deducted from the wages of employees in payment of membership dues in a labor organization: Provided, That the employer has received from each employee, on whose account such deductions are made, a written assignment which shall not be irrevocable for a period of more than one year, or beyond the termination date of the applicable collective agreement, whichever occurs sooner; . . .

\* \* \* \* \*

### APPENDIX C

The following table of exhibits referred to in respondent's brief is presented pursuant to Rule 18(f) of the Rules of the Court. References are to pages of the typewritten transcript of record.

Exhibit Number	Identified	Offered	Received
1(i)	10	10	11
7	64	90	91
8	65	91	91
9	65	73	73
10	66	75	75
11	66	75	76
14	93	93	93

**In the United States Court of Appeals  
for the Ninth Circuit**

---

**NATIONAL LABOR RELATIONS BOARD, PETITIONER**

*v.*

**AARON NEWMAN, DANIEL NEWMAN, PAUL NEWMAN  
AND CARL NEWMAN, A PARTNERSHIP d/b/a  
COLONY FURNITURE COMPANY, RESPONDENT**

---

**On Petition for Enforcement of an Order of  
the National Labor Relations Board**

---

**BRIEF FOR THE NATIONAL LABOR RELATIONS  
BOARD**

---

**ARNOLD ORDMAN,**  
*General Counsel,*

**DOMINICK L. MANOLI,**  
*Associate General Counsel,*

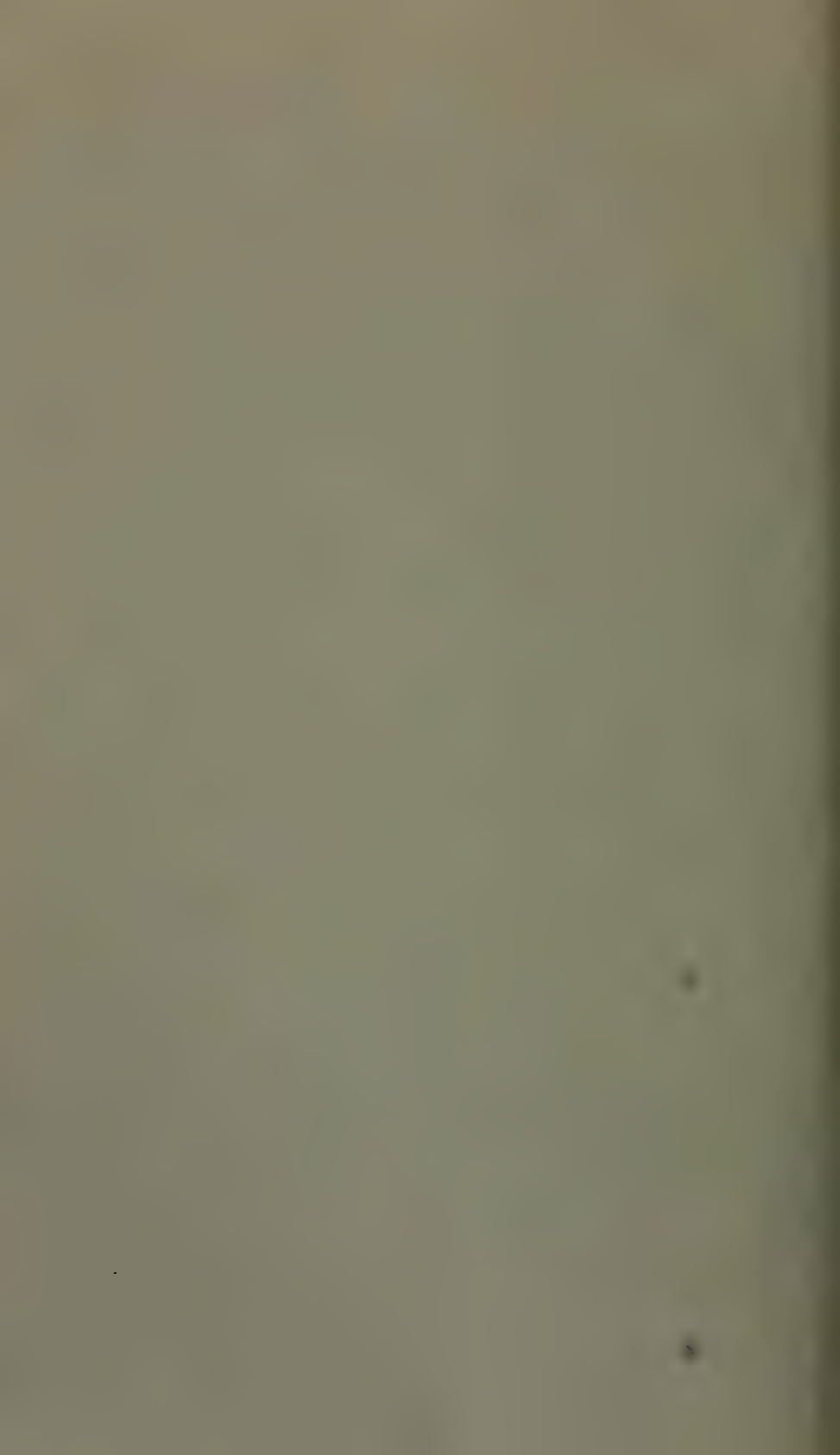
**MARCEL MALLET-PREVOST,**  
*Assistant General Counsel,*

**GARY GREEN,  
BERNARD M. DWORSKI,**  
*Attorneys,*

*National Labor Relations Board.*

---





## INDEX

	Page
Jurisdiction .....	1
Statement of the case .....	2
I. The Board's findings of fact .....	2
A. Background .....	2
B. Contract negotiations commence: the Com- pany by-passes the Union and bargains di- rectly with employees .....	3
C. Negotiations continue: the parties reach agreement on all terms .....	5
D. Aaron Newman has a "change of heart" and the Company refuses to execute the May 18 agreement .....	7
II. The Board's conclusions and order .....	8
Argument .....	10
I. Substantial evidence on the record as a whole supports the finding of the Board that the Com- pany failed to bargain in good faith with the Union in violation of Section 8(a) (5) and (1) of the Act .....	10
A. The divided and fluctuating bargaining au- thority .....	11
B. The refusal to execute the agree-upon con- tract .....	12
C. The attempts to undermine the Union's rep- resentative status .....	14
II. The Board's order is valid and proper .....	16
Conclusion .....	25
Appendix A .....	26
Appendix B .....	29

## AUTHORITIES CITED

Cases:	Page
<i>Heinz Co. v. N.L.R.B.</i> , 311 U.S. 514 .....	14
<i>Lion Oil Co. v. N.L.R.B.</i> , 245 F. 2d 376 (C.A. 8) ....	12
<i>Lozano Enterprises v. N.L.R.B.</i> , 327 F. 2d 814 (C.A. 9) .....	14
<i>May Dept. Stores Co. v. N.L.R.B.</i> , 326 U.S. 376 ....	18
<i>Medo Photo Supply Corp. v. N.L.R.B.</i> , 321 U.S. 678 .....	15
<i>N.L.R.B. v. A.P.W. Products Co.</i> , 316 F. 2d 899 (C.A. 2) .....	22
<i>N.L.R.B. v. Bro. of Painters, etc., Local 1385</i> , 334 F. 2d 729 (C.A. 7) .....	18
<i>N.L.R.B. v. Elcc. Vacuum Cleaner Co., Inc.</i> , 315 U.S. 685 .....	19, 20, 22, 23
<i>N.L.R.B. v. Fitzgerald Mills Corp.</i> , 313 F. 2d 260 (C.A. 2), cert. den., 375 U.S. 834 .....	12
<i>N.L.R.B. v. Hibbard Dowel Co.</i> , 273 F. 2d 565 (C.A. 7) .....	12
<i>N.L.R.B. v. Holly-General Co.</i> , 305 F. 2d 670 (C.A. 9) .....	14
<i>N.L.R.B. v. Howard-Cooper Co.</i> , 259 F. 2d 558 (C.A. 9) .....	15
<i>N.L.R.B. v. Howe Scale Co.</i> , 311 F. 2d 502 (C.A. 7) .....	15
<i>N.L.R.B. v. Gene Hyde</i> , 339 F. 2d 568 (C.A. 9) ....	14
<i>N.L.R.B. v. Insurance Agents' Intern. Union</i> , 361 U.S. 477 .....	10
<i>N.L.R.B. v. Intern. Hod Carriers, etc., Local 300</i> , 287 F. 2d 605 (C.A. 9) .....	17
<i>N.L.R.B. v. Intern. Union, Progressive Mine Work- ers of America</i> , 375 U.S. 396, rev'sg per curiam, 319 F. 2d 428 (C.A. 7) .....	21
<i>N.L.R.B. v. Jeffries Banknote Co.</i> , 281 F. 2d 893 (C.A. 9) .....	14
<i>N.L.R.B. v. Katz</i> , 369 U.S. 736 .....	14, 20
<i>N.L.R.B. v. Nesen</i> , 211 F. 2d 559 (C.A. 9), cert. den., 348 U.S. 820 .....	12, 14
<i>N.L.R.B. v. Seven-Up Bottling Co.</i> , 344 U.S. 344 ....	16
<i>N.L.R.B. v. Stanislaus Implement &amp; Hardware Co., Ltd.</i> , 226 F. 2d 377 (C.A. 9) .....	10

### III

Cases—Continued	Page
<i>N.L.R.B. v. Union Mfg. Co.</i> , 179 F. 2d 511 (C.A. 5) .....	16
<i>N.L.R.B. v. Warrensburg Board &amp; Paper Corp.</i> , 340 F. 2d 920 (C.A. 2) .....	17, 19, 24
<i>N.L.R.B. v. WATE, Inc.</i> , 310 F. 2d 700 (C.A. 6), enf'g <i>per curiam</i> 132 NLRB 1338 .....	17, 20
<i>Pacific Coast Ass'n of Pulp &amp; Paper Mfrs. v. N.L.R.B.</i> , 304 F. 2d 760 (C.A. 9) .....	12, 23
<i>Phelps-Dodge Corp. v. N.L.R.B.</i> , 313 U.S. 177 .....	16
<i>Quaker State Oil Refining Corp. v. N.L.R.B.</i> , 270 F. 2d 40 (C.A. 3), cert. den., 361 U.S. 917 .....	15
<i>Sheet Metal Workers Union, Local 65</i> , 120 NLRB 1678 .....	21
<i>Henry I. Siegel Co. v. N.L.R.B.</i> , 340 F. 2d 309 (C.A. 2) .....	20
<i>Virginia Elec. &amp; Power Co. v. N.L.R.B.</i> , 319 U.S. 533 .....	19
<i>Wallace Corp. v. N.L.R.B.</i> , 323 U.S. 248 .....	15
<i>Warrensburg Board &amp; Paper Co.</i> , 143 NLRB 398..	21, 24

#### Statute:

National Labor Relations Act, as amended (61 Stat. 136, 73 Stat. 519, 29 U.S.C., Sec. 151, <i>et seq.</i> ) .....	1
Section 8(a) (1) .....	2, 10
Section 8(a) (5) .....	2, 10
Section 8(d) .....	10
Section 10(c) .....	16
Section 10(d) .....	24
Section 10(e) .....	1



**In the United States Court of Appeals  
for the Ninth Circuit**

---

No. 20,108

NATIONAL LABOR RELATIONS BOARD, PETITIONER

*v.*

AARON NEWMAN, DANIEL NEWMAN, PAUL NEWMAN  
AND CARL NEWMAN, A PARTNERSHIP d/b/a  
COLONY FURNITURE COMPANY, RESPONDENT

---

**On Petition for Enforcement of an Order of  
the National Labor Relations Board**

---

**BRIEF FOR THE NATIONAL LABOR RELATIONS  
BOARD**

---

**JURISDICTION**

This case is before the Court upon the petition of the National Labor Relations Board for enforcement of its order issued against the respondent on November 15, 1963, pursuant to Section 10(e) of the National Labor Relations Act, as amended (61 Stat. 136, 73 Stat. 519, 29 U.S.C., Sec. 151, *et seq.*). The



Board's decision and order (R. 41-43)<sup>1</sup> are reported at 144 NLRB 155; a subsequent Board order (R. 44-45), issued on the Board's own motion to clarify the November 1963 order, is unreported. This Court has jurisdiction, the unfair labor practices having occurred in Los Angeles, California.

## STATEMENT OF THE CASE

### I. The Board's findings of fact

The Board found that the Company refused to bargain in good faith with the Union,<sup>2</sup> in violation of Sections 8(a)(5) and (1) of the Act. The facts upon which the Board's decision rest may be summarized as follows:

#### A. *Background*

Respondent partnership is composed of Aaron Newman and his three sons, Daniel, Paul and Carl Newman. Aaron holds the majority ownership interest and is in charge of respondent's principal office in Linden, New Jersey. Daniel Newman is in charge of respondent's Los Angeles plant, the only facility involved herein. In June 1960, shortly after the Los Angeles plant was opened, the Union and respondent executed a bargaining agreement covering the pro-

---

<sup>1</sup> References to formal documents reproduced as "Volume I, Pleadings" are designated "R." References to portions of the stenographic transcript reproduced pursuant to Court Rules 10 and 17 are designated "Tr." References designated "G.C. Ex." are to the General Counsel's exhibits.

<sup>2</sup> Furniture Workers Union, Local 3161, United Brotherhood of Carpenters and Joiners of America, AFL-CIO.

duction and maintenance employees working there (R. 24; Tr. 43-44). Roy Taylor, business representative, signed this agreement for the Union; Daniel Newman signed for the Company (R. 24; Tr. 45). After this agreement expired in July 1961, the Union's majority status was put in issue, a Board election was conducted, and the Union was certified in September 1961 as the exclusive representative of the production and maintenance employees at the Los Angeles plant (R. 24; Tr. 46-47).

**B. *Contract negotiations commence: the Company bypasses the Union and bargains directly with employees***

Following the certification, negotiations for a new contract commenced. At the first meeting, Aaron Newman appeared for respondent and told Taylor, the Union's representative, that Daniel Newman was currently out of town but would return to "negotiate the contract and sign it with the Union" (R. 24; Tr. 47-48). Aaron also questioned Taylor about the Union's proposal and Taylor presented him with a copy the contents of which were then discussed (Tr. 48).

On about October 2, 1961, the parties held their second bargaining session. This time, Daniel Newman was present as Company representative. Daniel and Taylor discussed a variety of contract topics—including arbitration, pension plan and Union dues—and reached agreement on some terms. For example, Taylor agreed to yield to Daniel's proposal that the existing health and welfare plan be retained. Daniel

also expressed concern that a dues provision in the contract might cause a hardship to some employees who had not been paying dues during the period following expiration of the 1960 contract. Taylor answered that the employees would have 30 days after execution of the new contract, plus an additional period "to work it out some way so it won't be a hardship" (Tr. 49-52).

Daniel Newman then assembled the plant employees in the absence of their Union representative, told them that he had a contract proposal from the Union, and asked the employees to decide among themselves if they wanted him to sign it. He asserted that execution of the Union's contract would require the Company to change its existing health and welfare plan which was "better" than the one proposed by the Union; and that old employees "would have to pay all their dues up [in] . . . one payment . . . and there was no use in them running up to the office and asking them to take out partial payments because they couldn't do it." (Tr. 15).

On October 18, 1961, the Union filed a charge with the Board alleging that Daniel Newman's above-described conduct violated Section 8(a)(1) and (5) of the Act. The Board's General Counsel issued a complaint, but no hearing was conducted. Instead, the parties executed a Settlement Agreement, approved on January 12, 1962, by the Board's Regional Director. In the Settlement Agreement, respondent agreed to post a notice and comply with all its provisions, including the following assurances: "We will not in any manner interfere with, restrain, or coerce our em-

ployees in the exercise of their right to self-organization . . . We will bargain collectively upon request with the [Union and] . . . We will not ask our employees to decide for themselves whether we should execute a collective bargaining agreement with the [Union]." The Regional Director agreed to take no further action in the case "contingent upon compliance" with the terms of the settlement (R. 9-10).

***C. Negotiations continue: the parties reach agreement on all terms***

Meanwhile, from October 1961 to January 1962, the parties continued to meet for contract negotiations (Tr. 52-53), Daniel Newman acting as the Company representative. During these sessions, the Union's proposed arbitration clause emerged as one of the main issues separating the parties. Daniel Newman stated that his father was strongly opposed to arbitration; Taylor replied by noting that such a provision had been incorporated in the parties' last contract. Finally, Daniel asked Taylor to get Aaron's approval first by long-distance telephone. Daniel assured the Union that "his dad would live up to" the provision if Daniel signed but stated that it would be better for Taylor to talk to him first: "maybe you will get him to understand it" (Tr. 61). After listening to Taylor's discussion over the telephone, Aaron responded, "Well, you and Dan go on and work the thing out" (Tr. 61-62).

Thereafter, on several occasions, Taylor was requested by Daniel to discuss a variety of contract details with Aaron by telephone, after bargaining on

the same subjects with Daniel (Tr. 62). Also, on one occasion in January 1962, Aaron appeared at a bargaining session in Los Angeles and—although Daniel was present—did most of the talking for the Company; also, Aaron expressed firm opposition to the inclusion of an arbitration clause (Tr. 122-123, 145). By the end of February, however, respondent's resistance faded and Aaron sent the Union, from his New Jersey office, a written counterproposal containing an arbitration clause (G.C. Ex. 7, 8).

By letter to Aaron Newman dated March 6, Taylor advised that he was dissatisfied with attempting to reach an agreement on a contract through a written exchange of proposals and counter-proposals between himself and Aaron Newman. Taylor further advised the latter that he was requesting the services of the Federal Mediation and Conciliation Service in negotiating a contract with the respondent, and concluded his letter with the following request:

“ . . . [T]herefore, will you please delegate authority to someone locally to negotiate with the Union and a mediator from the Federal Mediation and Conciliation Service in order that we may negotiate further and conclude our negotiations with a signed agreement.” (G.C. Ex. 10).

Aaron Newman replied to Taylor by letter dated March 24, concluding with the following language:

“ . . . Our Mr. Dan Newman is and always has been available to negotiate with you. He has had ample authority at all times. Because of my long experience and the good advice of Mr. Joseph Wells, our company lawyer, he naturally con-



sults with us. However, this had not been any cause for delay in arriving at a satisfactory understanding with you." (G.C. Ex. 11).

Negotiations proceeded thereafter in the offices of Federal Conciliator Jules Medoff, centering around the Company's February counterproposal. Daniel Newman told Medoff, in Taylor's presence, that he had authority to negotiate and conclude an agreement (Tr. 76-77), but insisted that no contract would be signed which incorporated the Union's proposed pension plan (Tr. 77). After Taylor consented to omit this provision, the parties reached agreement on all other matters (R. 26; Tr. 78-92). On May 18, Daniel Newman told Taylor to reduce the agreement to writing and "we will sign it" (R. 26; Tr. 91-92, 113). The contract reached was to be effective for one year from May 18, 1962, and from year to year thereafter subject to 60 days' notice (G.C. Ex. 7, p. 12).

**D. Aaron Newman has a "change of heart" and the Company refuses to execute the May 18 agreement**

Taylor had copies of the contract prepared and sent to Daniel Newman for signature and, after a week or more had passed without response, telephoned Daniel to inquire about the delay. On this and a subsequent occasion, Daniel asserted that he had not yet had time to read the contract (R. 26; Tr. 97-98). Taylor finally informed Conciliator Medoff about the delay. Later, Medoff telephoned Taylor, and told him that Daniel wanted Taylor to meet with Aaron when the latter would be present at the plant. Taylor replied that he had no objection to



meeting with the father, but that he "had no intention of negotiating" because a contract had already been concluded (R. 26; Tr. 99). Medoff assured him that there would be no problem because Daniel had agreed to sign the contract if his father didn't (R. 26; Tr. 99-100).

On about July 18, Taylor met with Aaron and Daniel. Aaron stated that he had had a "change of heart" about the inclusion of an arbitration clause in the contract and wanted to renegotiate the matter (R. 26; Tr. 101, 120). Taylor protested and refused to renegotiate; the Company has refused to this date to sign the contract (*ibid.*).

## II. The Board's Conclusions and order

Upon the foregoing facts, the Board concluded that respondent violated Section 8(a)(5) and (1) of the Act by refusing to bargain in good faith with the Union in that it confronted the Union in negotiations with a divided and fluctuating bargaining authority and refused to execute a contract already agreed to. Moreover, the Board ruled respondent's unfair practices subsequent to January 12, 1962, effectively breached the Settlement Agreement of that date and warranted inclusion of respondent's October 1961 conduct in the Board hearing. Such conduct was likewise found violative of Sections 8(a)(5) and (1) as an attempt to undermine the Union's representative status (R. 30-31).

The Board ordered respondent to cease and desist from the unfair practices found, to post an appropri-

ate notice, and to execute the May 18, 1962, agreement upon the Union's request.<sup>3</sup>

Subsequently, on September 14, 1964, the Board issued an Order on its own motion clarifying the above-described Decision. In the September 1964 Order, the Board took administrative notice of a dispute between the Company and the Union over the interpretation to be given the Board's remedy, and acknowledged the existence of a "latent ambiguity" regarding the effective duration of the contract ordered to be signed, upon request. To clarify the intent of its original November 1963 order, the Board ordered insertion in its order of the following italicized clause, thus requiring respondent: . . . "either to execute the foregoing agreement, *this agreement to be effective from May 18, 1962 to at least the next renewal date as provided therein following signature*, or to bargain collectively with the Union . . . ." <sup>4</sup>

---

<sup>3</sup> The Trial Examiner's Recommended Order had called for respondent to execute said agreement "forthwith" (R. 32). The Board noted however, that—as of the date of its order—more than a year had elapsed since May 18, 1962 and the Union might no longer desire to insist upon the terms negotiated. Accordingly, the Board ordered respondent to execute the agreement *or* to bargain collectively, depending upon the nature of the Union's request.

<sup>4</sup> On October 1, 1964, respondent filed a motion for reconsideration with the Board, contending that the Order Clarifying Decision constituted a substitution of a new remedial order; the Board denied this motion on November 30, 1964, as lacking in merit (R. 46-48, 50).

## ARGUMENT

### I. Substantial Evidence on the Record as a Whole Supports the Finding of the Board That the Company Failed to Bargain in Good Faith With the Union in Violation of Section 8(a)(5) and (1) of the Act

The test of good faith bargaining is defined in Section 8(d) of the Act as follows:

For the purpose of this section, to bargain collectively is the performance of the mutual obligation to the employer and the representative of the employees to meet at reasonable times and confer in good faith with respect to wages, hours, and other terms and conditions of employment, or the negotiations of an agreement, or any question arising thereunder, and the execution of a written contract incorporating any agreement reached if requested by either party, but such obligation does not compel either party to agree to a proposal, or require the making of a concession;

\*       \*       \*       \*

The function of applying this standard is the Board's, "to determine . . . whether a party's conduct . . . evidences a real desire to come into agreement . . . [by] drawing inferences from the conduct of the parties as a whole." *N.L.R.B. v. Insurance Agents' International Union*, 361 U.S. 477, 498.

As this Court has stated (*N.L.R.B. v. Stanislaus Implement and Hardware Company, Ltd.*, 226 F. 2d 377, 380):

An unpretending, sincere intention and effort to arrive at an agreement is required by statute; the absence thereof constitutes an unfair labor practice. *N.L.R.B. v. National Shoes*, 2 Cir.,

1953, 208 F. 2d 688; *N.L.R.B. v. Shannon*, 9 Cir., 1953, 208 F. 2d 545; *N.L.R.B. v. Nesen*, 9 Cir., 1954, 211 F. 2d 559.

“Good faith” is a state of mind which can be resolved only through an application of the facts in each particular case. *N.L.R.B. v. American National Insurance Co.*, 1952, 343 U.S. 395, 410, 72 S. Ct. 824, 96 L. Ed. 1027.

We submit that the facts of this case amply support the bad-faith inference drawn by the Board.

#### **A. *The Divided and Fluctuating Bargaining Authority***

As shown in the Statement, pp. 3, 5-6, respondent deprived the Union—at least from September 1961 until March 1962—of one of the elementary and essential conditions for genuine collective bargaining, i.e., the availability of an authorized negotiator for face-to-face negotiations. Thus, by effectively dividing bargaining authority during this period between Aaron Newman, whose office was in New Jersey, and Daniel Newman, whose office was in Los Angeles, respondent in effect required the Union to negotiate a contract through long-distance telephone calls and written correspondence. Although Aaron Newman told the Union at the start of negotiations that Daniel would be present thereafter to represent the Company (*supra*, p. 3), the subsequent conduct of both father and son made it plain to the Union that the absent father would first have to be convinced before the son would agree. Time and again, Daniel asked the Union to explain contract details for his father’s approval (*supra*, pp. 5-6) and, on some occasions, Aaron

appeared at Los Angeles bargaining sessions acting as if he were, in fact, the Company's principal negotiator. As the Board held, effective collective bargaining could not be favored in such a situation of divided and fluctuating authority" (R. 30). See *N.L.R.B. v. Fitzgerald Mills Corp.*, 313 F. 2d 260, 267 (C.A. 2), cert. denied, 375 U.S. 834; *N.L.R.B. v. Hibbard*, 273 F. 2d 565, 568 (C.A. 7).

After March 6, as a result of Union protest and insistence upon an effective delegation of authority to a *local* representative, the situation changed. Aaron Newman, in his March 14 letter, gave the Union reasonable ground to believe that Daniel could negotiate and execute a contract (*supra*, pp. 6-7), a belief Daniel himself expressly confirmed to the Federal Mediator (*supra*, p. 7). But respondent can hardly claim that its post-March conduct excuses or moots what went before. *Pacific Coast Ass'n of Pulp & Paper Mfrs. v. N.L.R.B.*, 304 F. 2d 760, 765 (C.A. 9). Such a claim would require the unwarranted assumption that the improper division of authority had no impact on negotiations during its occurrence. *Lion Oil Company v. N.L.R.B.*, 245 F. 2d 376, 379 (C.A. 8).

#### **B. The refusal to execute the agreed-upon contract**

Further evidence of respondent's bad faith is shown by Aaron Newman's "change of heart" on July 18, when he told the Union that he wanted to renegotiate the arbitration clause already accepted by Daniel Newman (*supra*, p. 8). Here, as in *N.L.R.B. v. Nesen*, 211 F. 2d 559, 563 (C.A. 9), cert. den., 348



U.S. 820, "respondent failed to recognize agreements reached by his bargaining representative after leading the Union to believe that the bargaining representative had full authority to conclude an agreement." Thus, as already shown, respondent reacted to the Union's demand for an authorized local negotiator by assuring the Union that Daniel Newman had "ample authority" (*supra*, p. 6). In the meetings that followed under the Mediator's auspices, Daniel himself expressly confirmed his father's delegation of authority to him to "negotiate and conclude" an agreement. And at their May 18 meeting, Daniel Newman acknowledged that the Company and the Union had reached agreement on all contract issues, and that he would sign the document when it was prepared (*supra*, p. 7).<sup>5</sup> Admittedly, the prepared draft was an accurate embodiment of the parties' agreement (R. 28; Tr. 148).

The arbitration provision which Aaron subsequently sought to have removed from the contract had been

---

<sup>5</sup> Respondent contended before the Board that Daniel had not been authorized to sign a contract without Aaron's prior approval. In light of the evidence summarized above, pp. 6-8, however, there was ample basis for the Board's rejection of this claim.

The fact that the Union's approval of the agreement on May 18 was subject to ratification by the affected employees does not mean, as respondent urged below, that respondent should likewise be free to disavow its representative's agreement. For, as the Board explained, "it is patent that respondent understood at all times during the negotiations that any agreement reached would have to be ratified by the employees, whereas Aaron's representations to the Union's negotiator led the latter reasonably to believe that Daniel could conclude an agreement on behalf of respondent." (R. 41-42; Tr. 119-120).



specifically pointed out to Daniel Newman as a part of the contract agreed upon (R. 26; Tr. 90) and, moreover, was one of the provisions which Aaron Newman himself had presented in the Company's written counterproposal of February 28, 1962. Hence, even if there were a limitation upon Daniel's authority to conclude an agreement, Aaron's "change of heart" was nonetheless a blatant manifestation of bad faith, since he thereby repudiated his own offer after it had been accepted by the Union, after all other contract issues had been settled, and after the lapse of several months without any suggestion by the Company that their offer might be withdrawn.

As already shown, *supra*, p. 10, the Act requires "the execution of a written contract incorporating any agreement reached if requested by either party . . .". Hence, respondent's refusal to sign the agreement reached on May 18, 1962, not only provides a persuasive basis for a finding of bad faith bargaining, it also constitutes, in and of itself, a violation of Section 8(a) (5). *N.L.R.B. v. Gene Hyde*, 339 F. 2d 568, 571 (C.A. 9); *Lozano Enterprises v. N.L.R.B.*, 327 F. 2d 814, 818-819 (C.A. 9); *N.L.R.B. v. Holly-General Co.*, 305 F. 2d 670, 671-672 (C.A. 9); *N.L.R.B. v. Jeffries Banknote Co.*, 281 F. 2d 893, 896 (C.A. 9); *Nesen, supra* at 563; see also *N.L.R.B. v. Katz*, 369 U.S. 736; *Heinz Co. v. N.L.R.B.*, 311 U.S. 514, 523-524.

**C. *The attempts to undermine the Union's representative status***

In light of the foregoing, there can be no question about the propriety of the Board's determination to

consider Daniel Newman's conduct during October 1961 despite the execution of a settlement agreement in January 1962 covering said conduct. As the agreement itself states, the Board therein agreed not to litigate the October incidents only on the condition that respondent comply with its agreement to refrain from committing future related violations. The Supreme Court's holding in *Wallace Corp. v. N.L.R.B.*, 323 U.S. 248, 254-255, is controlling here:

[The Board] has consistently gone behind [settlement] agreements, however, where subsequent events have demonstrated that efforts at adjustment have failed to accomplish their purpose, or where there has been a subsequent unfair labor practice. We think this rule adopted by the Board is appropriate to accomplish the Act's purpose with fairness to all concerned.

Nor can the Company reasonably deny the impropriety of the October conduct. In assembling the plant employees outside the presence of their Union negotiator, misrepresenting the Union's position on contract issues, suggesting that the Company's contract proposal was "better" for the employees, and telling employees to decide among themselves whether the Company should sign the Union's contract, respondent manifestly subverted the mode of bargaining established by the Act. *Medo Photo Supply Corp. v. N.L.R.B.*, 321 U.S. 678, 683-684; *N.L.R.B. v. Howe Scale Co.*, 311 F. 2d 502, 504 (C.A. 7); *Quaker State Oil Refining Co., v. N.L.R.B.*, 270 F. 2d 40, 45-46 (C.A. 3), cert. denied, 361 U.S. 917; *N.L.R.B. v. Howard-Cooper Corp.*, 259 F. 2d 558

(C.A. 9); *N.L.R.B. v. Union Mfg. Co.*, 179 F. 2d 511, 513 (C.A. 5).

## II. The Board's Order is Valid and Proper

It is clear that the Board's power to issue remedial orders encompasses the power to order an employer presently to execute a contract which he wrongfully refused to execute in the past. The inevitable lapse of time between the unfair labor practice and the issuance of the Board's order sometimes raises complications, however, as the instant case illustrates. The general directions of the Act, we submit, and the Board's extensive experience in drafting remedial provisions, provide the source for resolving these difficulties.

Thus, Section 10(c) of the Act empowers the Board to order "such affirmative action . . . as will effectuate the policies of this Act." In implementing this mandate, the Board is to seek "a restoration of the situation, as nearly as possible, to that which would have obtained but for the [unfair labor practice]." *Phelps Dodge Corp. v. N.L.R.B.*, 313 U.S. 177, 199. Because of the "infinite variety of specific situations," Congress has left the task of remedy—"the adaptation of means to end"—to the administrative process subject only to limited judicial review. *Ibid.* Accord: *N.L.R.B. v. Seven-Up Bottling Co.*, 344 U.S. 344, 346. We submit that the Board's remedial order herein, tailored as it is to provide the particular form of redress which the situation warrants, falls well within the broad discretionary power accorded the Board and, consequently, warrants enforcement.

First, the Board's order grants the Union the option of (1) insisting upon present execution of the contract previously negotiated or (2) bargaining with respondent for a new arrangement. Since 18 months had elapsed between the respondent's wrongful refusal and the issuance of the Board's order, with attendant interim changes in such matters as the current cost of living, this optional feature of the remedy clearly constitutes a sensible accommodation. And in cases such as *N.L.R.B. v. Warrensburg Board & Paper Corp.*, 340 F. 2d 920, 922 (C.A. 2); and *N.L.R.B. v. WATE, Inc.*, 310 F. 2d 700 (C.A. 6), enf'g *per curiam* 132 NLRB 1338, 1339, the Courts have enforced contract-refusal remedies containing this "optional" feature.

Second, respondent objected to the Board order below on the ground that it would require the execution of a contract "for a term larger than that specified in the contract—here, one year" (R. 47). This contention is clearly lacking in merit. The contract here provided for an effective duration of one year from May 18, 1962, *and from year to year thereafter* subject to timely notice of a contrary intent (*supra*, p. 9), and no such notice was ever given. Hence, the contract reached by the parties itself contemplated that the agreement embodied therein sought might well endure indefinitely. Indeed, in *N.L.R.B. v. International Hod Carriers', etc. Local 300*, 287 F. 2d 605, 610 (C.A. 9), the contract before the Court contained an identical provision regarding duration and the Court characterized it as "common practice . . . [of] recognized . . . validity" for union contracts

thereby to provide for long-range prospective application.

A different problem might be presented had the respondent, during the pendency of this case before the Board, given the Union notice of intention to terminate the contract—without prejudice, of course, to its allegation that no contract had ever become binding. Obviously, there is an element of artificiality in such a gesture, but that cannot aid respondent. Had respondent executed the contract when requested, as required by law, procedures for terminating the contract would have been clearly established. Only because of respondent's own wrongdoing was it saddled with the awkwardness of seeking to terminate a contract whose current existence it was simultaneously disputing. See *May Department Stores Co. v. N.L.R.B.*, 326 U.S. 376, 383-385.

Compare *N.L.R.B. v. Brotherhood of Painters, etc., Local No. 1385*, 334 F. 2d 729, 731-732 (C.A. 7). There, a Union had unlawfully refused to execute a contract with a duration clause, like the one involved herein, providing for a term of one year with automatic renewal thereafter absent timely notice. The Union was not required to execute the contract, however, because (1) the one year period had already expired *and* (2) timely notice had been given to forestall automatic renewal.

Besides, even if respondent could show here that the contract would have expired prior to the issuance of the Board's order, that would not mar the appropriateness of the Board's instant remedy. To restore the status quo, protect the rights which were



granted employees in the contract, and encourage parties to execute their agreed-upon contracts, the Board should be permitted to order present execution of past contracts except where the circumstances show that such an order would be "a patent attempt to achieve ends other than those which can fairly be read to effectuate the policies of the Act." *Virginia Electric & Power Co. v. N.L.R.B.*, 319 U.S. 533, 540. No such circumstances exist here.

To deny the Board that power in a case where the administrative process does not conclude until after the contract's stated term would merely "encourage purposeful delay." *Warrensburg, supra*, 340 F. 2d at 923, without satisfying any significant countervailing interest of the respondent. Whether the agreed-upon contract would have expired before or after the issuance of a Board order is, after all, an extraneous consideration, which will frequently turn upon matters wholly insignificant in terms of the remedial process. Congress, fully mindful that Board remedial orders necessarily issue only after the passage of considerable periods of time, has not introduced any relevant time limitation upon the Board and the Courts have, accordingly, refused to order immunity for the wrongdoers during the pendency of Board litigation.

Thus, in *N.L.R.B. v. Electric Vacuum Cleaner Co., Inc.*, 315 U.S. 685, the Supreme Court refused to reduce the effective period of a Board backpay award despite an allegation of Board delay in entering a final order. Such a delay, the Court acknowledged, would be unfortunate for all parties concerned, but



the victim of the unfair labor practice, it was held, should not be penalized for it. 315 U.S. at 697-698. Here, *a fortiori*, the Union should not be deprived of a remedy otherwise appropriate even if Board litigation did not conclude within the period of the contract. For here, it is respondent's wrongful conduct and not agency delay that consumed the contract period.

Closely in point is *Henry I. Siegel v. N.L.R.B.*, 340 F. 2d 309 (C.A. 2). There, the employer had wrongfully refused to incorporate a certain provision in his 1961 contract with the union. Prior to the issuance of a Board remedial order, the 1961 contract expired by its terms and the parties negotiated a new contract. Nonetheless, the Board ordered incorporation in a written and signed document of the previously omitted provision, and the Court approved:

“A party guilty of an unlawful refusal to bargain in connection with a particular contract does not become vested with immunity because the Board's processes have not been completed before the signature of a successor agreement.”  
[340 F. 2d at 311]

And in *WATE, Inc., supra*, the parties had also agreed upon a contract for one year with an automatic renewal provision. The Company should have signed the agreement on August 29, 1961. The Court enforced the Board's contract-execution remedy, although its effect was to render the contract effective after the date it might have expired by its terms, absent the unfair labor practice.<sup>6</sup>

---

<sup>6</sup> See also *N.L.R.B. v. Katz*, 369 U.S. 736, 748, n. 16, where the Supreme Court found without merit a respondent's re-

This is not to say that the intended duration of the dishonored contract is not a relevant consideration for the Board in its task of shaping a remedy. Indeed, in some cases, the Board itself has reduced the period of future effectiveness of a contract when ordering its execution. See *Sheet Metal Workers Union Local No. 65*, 120 NLRB 1678, 1679 and *Warrensburg Board & Paper Co.*, 143 NLRB 398, 399. In the cited cases, however, unlike this case, the respondents showed that they had already put into effect the contract provisions bargained for, hence mitigating the damage left to be remedied by the Board's order. We submit simply that a respondent may not succeed in profiting from his unfair practice merely because his unlawful refusal to sign may continue beyond the intended period of the contract.

For similar reasons, respondent may not here object to the Board's order because the original order contained a latent ambiguity which the Board subsequently clarified. Respondent argued before the Board that it was misled by the ambiguity, and thought that compliance therewith could be achieved by executing the contract to become effective for one year following signature (with automatic renewal) (R. 47). In its clarifying order, however, the Board specified that the contract was required to be effective from May 18, 1962—the date it should have

---

quest for denial of a bargaining order on the grounds of lapse of time and loss of majority status by the union in the period between the occurrence of the unfair labor practice and the Board's final order. Accord: *N.L.R.B. v. International Union, Progressive Mine Workers of America*, 375 U.S. 396, reversing *per curiam* 319 F. 2d 428, 437 ((C.A. 7).

been signed—until it expired by its own terms (R. 44-45).

Assuming *arguendo* that respondent was misled or confused, no bar to enforcement is raised. This case would thus present a situation like that in *Electric Vacuum Cleaners, supra*, where the Supreme Court agreed with the Board that a respondent may be held accountable for the entire period of damage to the victim, even when that period has been prolonged as a result of administrative mishap. See also *N.L.R.B. v. A.P.W. Products Co., Inc.*, 316 F. 2d 899 (C.A. 2), where a respondent was required to pay backpay for the period of the Trial Examiner's interim and erroneous ruling dismissing the complaint.

When the Board, on its own motion, noted that its order had not expressly and clearly resolved the question of effective duration of the contract to be signed, the problem posed was whether the period of time between the original order and the clarifying order should be included in the Company's remedial responsibility. To exculpate respondent for this period would necessarily deprive the Union and the employees of benefits lawfully earned, thereby aiding the wrongdoer at the expense of the wronged. The Board was surely justified, therefore, in refusing to suspend respondent's liability during the interim and in choosing the remedy which more adequately repaired the unlawful damage.

Moreover, respondent did not, after issuance of the Board's original order, petition the Board to clarify its order; nor did it offer to put the bargained-for

contract terms into effect pending resolution of its dispute over the interpretation of the Board's order. Accordingly, respondent has not been prejudiced by, or changed its position in reliance upon, the Board's original order. Hence, for purposes of analysis, the ambiguity in that may be ignored. This case is no different than it would have been had no Board order issued at all until September 1964 and had respondent then opposed enforcement on the ground of Board delay. *Electric Vacuum Cleaner, supra*, and the analysis already presented, *supra*, pp. 19-20, disposes of that contention.

Respondent has also contended that the continued passage of time during litigation meant that the Board's clarifying order amounted to a new order, modifying the original remedy, because a longer effective contract duration was thereby required. In part, this is sheer semantics. If the Board decided in 1963 that respondent should execute its contract upon request, to be effective from May 1962, then the issuance of an identical order in 1964 does not "modify" the original order. What is "modified" is not the order but the cost of compliance therewith, and it is only respondent's inaction during the interim which causes that "modification."<sup>7</sup>

Of course, if the Board had originally intended to require the contract to be effective only in the period

---

<sup>7</sup> As this Court has noted in analogous circumstances, "Labor-management relations are a continuum. Any rule that would hold them in a state of suspended animation during the pendency of an unfair labor practice charge would, in our view, be most unfortunate." *Pacific Coast Ass'n of Pulp and Paper Mfgs. v. N.L.R.B.*, 304 F. 2d 760, 765.

following its execution and then issued a subsequent order requiring the effective period to begin as of respondent's refusal to sign, this *would* constitute a modification of the original order and respondent would be entitled to "reasonable notice" prior thereto. Section 10(d) of the Act. But that is not this case. Here, the Board itself recited that its September 1964 order was merely "to clarify" the remedy already issued (R. 44). Respondent's argument to the contrary, i.e., that the Board had originally intended a different result than the one finally specified, was presented to the Board for consideration (R. 47) and was rejected (R. 50).<sup>8</sup>

---

<sup>8</sup> Respondent relied upon the fact that, in its original order, the Board characterized the contract as a "1-year agreement." Consequently, respondent argued, the Board evidenced an intention that respondent not be bound by the contract for longer than a 1-year period. But the fair inferences to be drawn from the Board's use of this phrase become apparent when it is placed back in context:

However, more than a year has elapsed since the 1-year agreement was reached between the negotiators for the Union and the Respondent and it is not clear whether the Union would now desire to submit this agreement to its members for ratification (R. 42).

Obviously, the Board was intending not to reduce the period of respondent's liability by this phrase, or even to describe the contract fully, but merely to indicate why the union was entitled to bargain for a new contract rather than insist upon the old one.

Much more revealing of the Board's intention is the fact that it supported its original remedial order by express citation of the *Warrensburg*, case (R. 42). There, as here, compliance with the Board's order required the respondent to execute a contract *to be effective from the date it should have been signed*.



## CONCLUSION

For the reasons stated, it is respectfully submitted that the Board's order should be enforced in full.

ARNOLD ORDMAN,  
*General Counsel,*

DOMINICK L. MANOLI,  
*Associate General Counsel,*

MARCEL MALLET-PREVOST,  
*Assistant General Counsel,*

GARY GREEN,  
BERNARD M. DWORSKI,  
*Attorneys,*

*National Labor Relations Board.*

August 1965.

## CERTIFICATE

The undersigned certifies that he has examined the provision of Rules 18 and 19 of this Court and in his opinion the tendered brief conforms to all requirements.

---

MARCEL MALLET-PREVOST  
*Assistant General Counsel*  
*National Labor Relations Board*



## APPENDIX A

The relevant provisions of the National Labor Relations Act, as amended (61 Stat. 136, 73 Stat. 519, 29 U.S.C., Secs. 151, *et seq.*) are as follows:

## RIGHTS OF EMPLOYEES

Sec. 7. Employees shall have the right to self-organization, to form, join, or assist labor organizations, to bargain collectively through representatives of their own choosing, and to engage in other concerted activities for the purpose of collective bargaining or other mutual aid or protection, and shall also have the right to refrain from any or all of such activities except to the extent that such right may be affected by an agreement requiring membership in a labor organization as a condition of employment as authorized in section 8(a) (3).

## UNFAIR LABOR PRACTICES

Sec. 8(a) It shall be an unfair labor practice for an employer—

(1) to interfere with, restrain, or coerce employees in the exercise of the rights guaranteed in section 7;

\* \* \* \*

(5) to refuse to bargain collectively with the representatives of his employees, subject to the provisions of section 9(a).

\* \* \* \*

(d) For the purposes of this section, to bargain collectively is the performance of the mutual obligation of the employer and the representative of the employees to meet at reasonable times and confer in good faith with respect to wages, hours, and other

terms and conditions of employment, or the negotiation of an agreement, or any question arising thereunder, and the execution of a written contract incorporating any agreement reached if requested by either party, but such obligation does not compel either party to agree to a proposal or require the making of a concession:

\* \* \* \*

Sec. 10(e) The Board shall have power to petition any court of appeals of the United States, . . . within any circuit . . . wherein the unfair labor practice in question occurred or wherein such person resides or transacts business, for the enforcement of such order and for appropriate temporary relief or restraining order, and shall file in the court the record in the proceedings, as provided in section 2112 of title 28, United States Code. Upon the filing of such petition, the court shall cause notice thereof to be served upon such person, and thereupon shall have jurisdiction of the proceeding and of the question determined therein, and shall have power to grant such temporary relief or restraining order as it deems just and proper, and to make and enter a decree enforcing, modifying, and enforcing as so modified, or setting aside in whole or in part the order of the Board. No objection that has not been urged before the Board, its member, agent, or agency, shall be considered by the court, unless the failure or neglect to urge such objection shall be excused because of extraordinary circumstances. The findings of the Board with respect to questions of fact if supported by substantial evidence on the record considered as a whole shall be conclusive. If either party shall apply to the court for leave to adduce additional evidence and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable

grounds for the failure to adduce such evidence in the hearing before the Board, its member, agent, or agency, the court may order such additional evidence to be taken before the Board, its member, agent, or agency, and to be made a part of the record . . . . Upon the filing of the record with it, the jurisdiction of the court shall be exclusive and its judgment and decree shall be final, except that the same shall be subject to review by the . . . Supreme Court of the United States upon writ of certiorari or certification as provided in section 1254 of title 28.

**APPENDIX B**

The following table of exhibits referred to in the Board's brief is presented pursuant to Rule 18(f) of the Rules of the Court. References are to the type-written transcript of record ("Tr."):

**GENERAL COUNSEL'S EXHIBITS**

Number	Identified	Offered	Received in evidence
7	65	90	91
8	65	91	91
10	66	75	75
11	66	75	76



UNITED STATES COURT OF APPEALS  
FOR THE NINTH CIRCUIT

J. HOWARD ARNOLD, Debtor in Possession

APPELLANT

vs.

FRANCES K. ARNOLD

APPELLEE

APPELLANT'S CLOSING BRIEF

Appeal from the  
UNITED STATES DISTRICT COURT for the  
NORTHERN DISTRICT OF CALIFORNIA  
SOUTHERN DIVISION

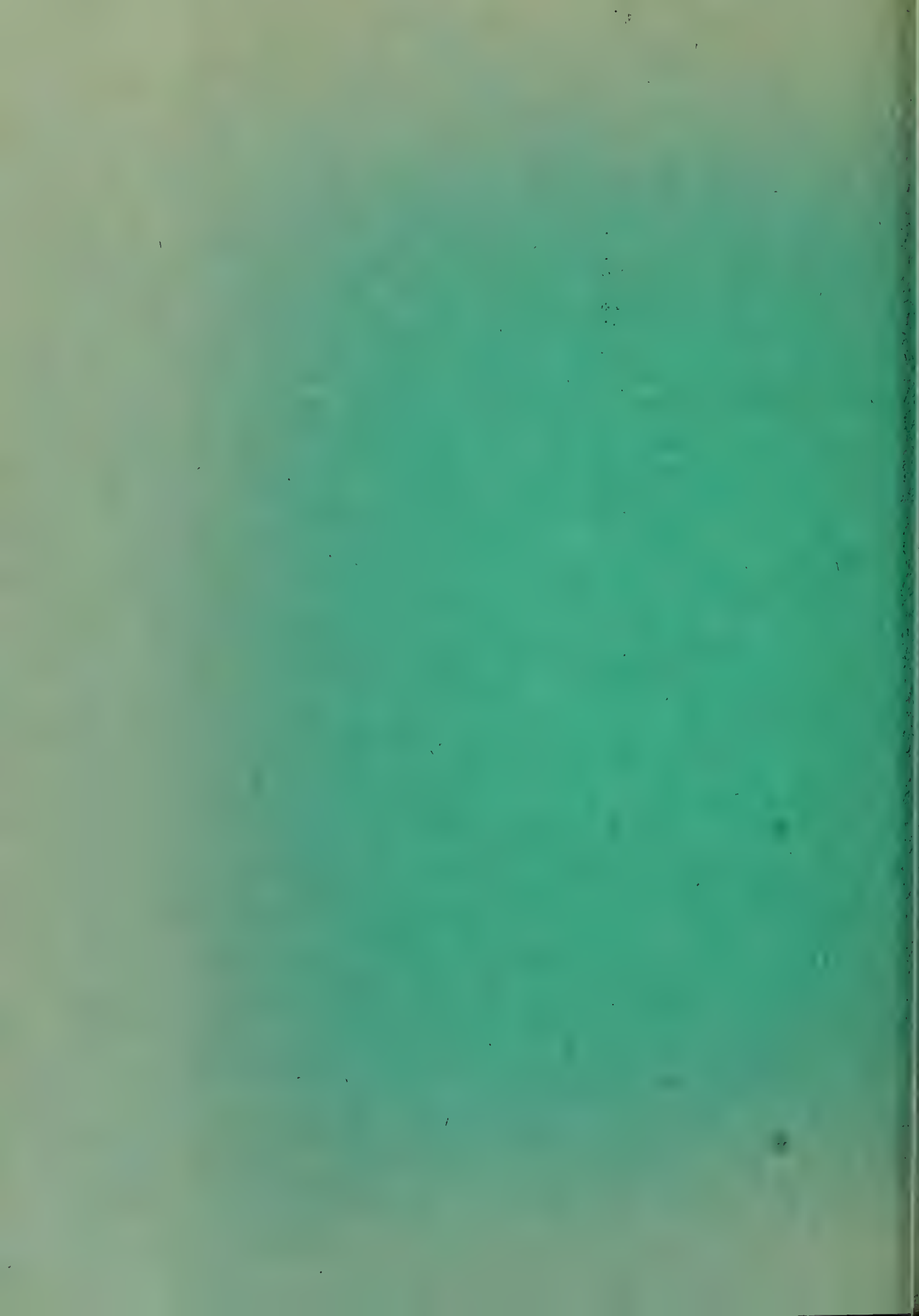
FILED

NOV 26 1965

FRANK H. SCHMID, CLERK

J. HOWARD ARNOLD  
Postoffice Box 919  
Berkeley 1, California  
APPELLANT, pro se





UNITED STATES COURT OF APPEALS  
FOR THE NINTH CIRCUIT

J. HOWARD ARNOLD, Debtor in possession

APPELLANT

vs.

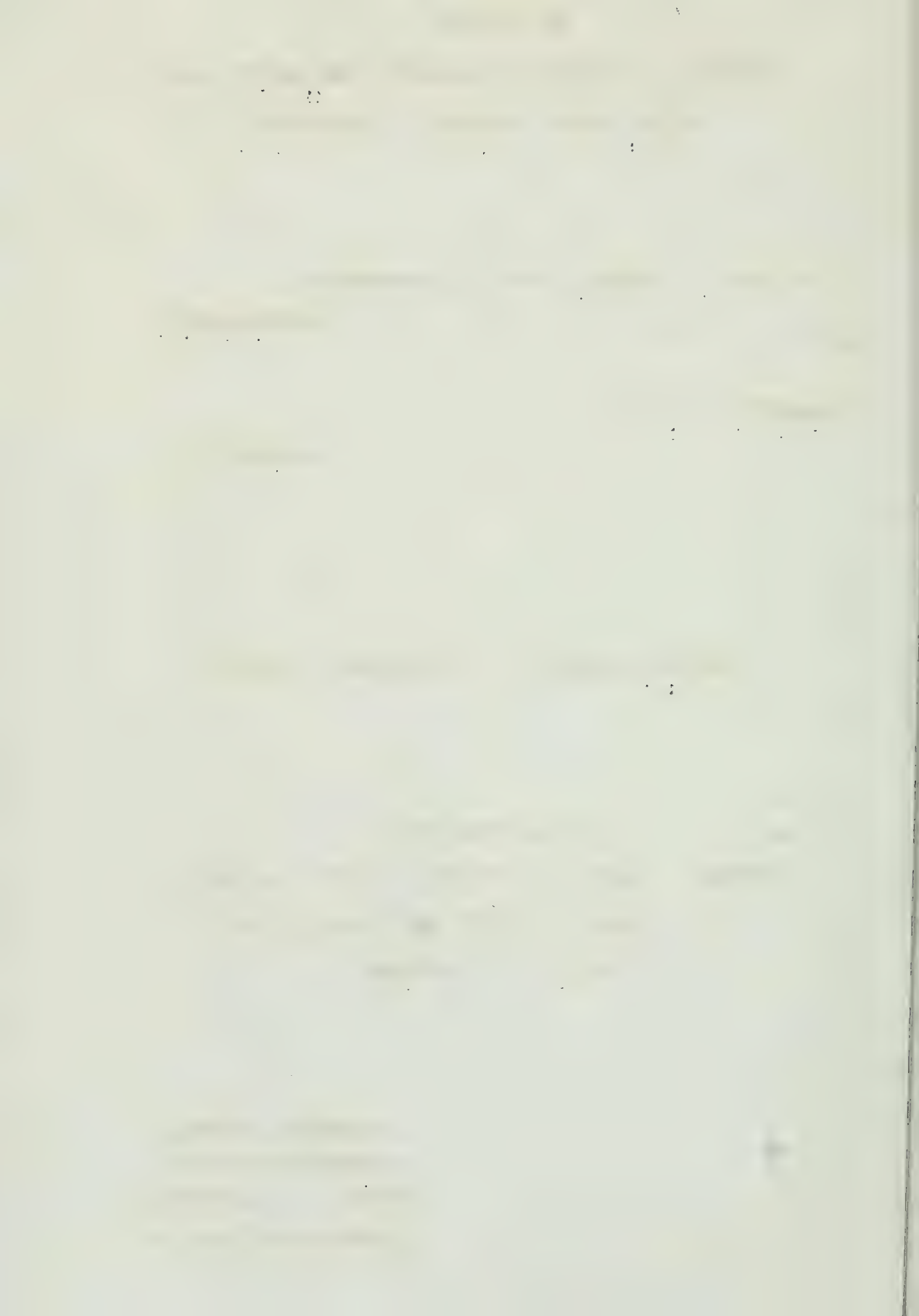
FRANCES K. ARNOLD

APPELLEE

APPELLANT'S CLOSING BRIEF

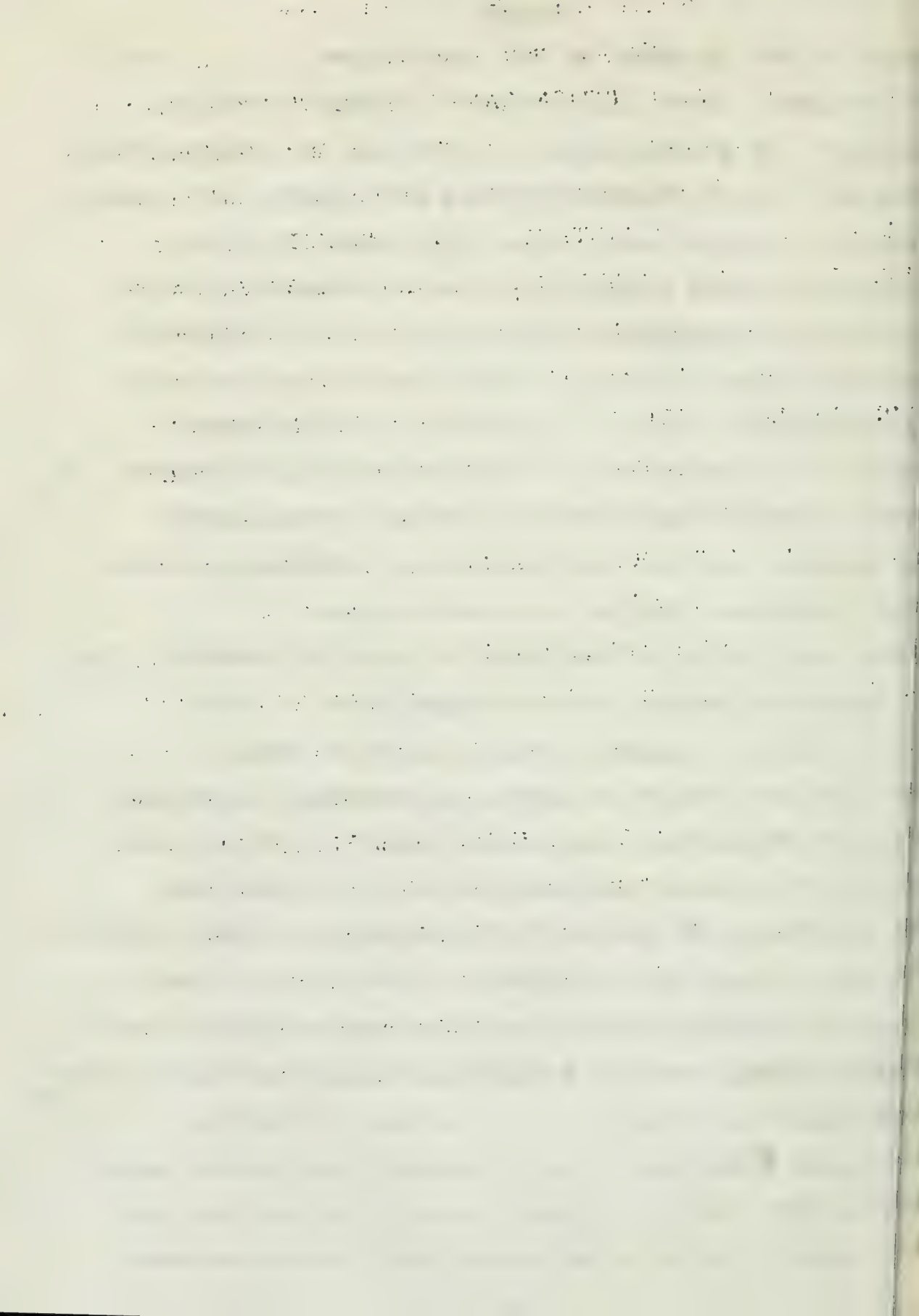
Appeal from the  
UNITED STATES DISTRICT COURT for the  
NORTHERN DISTRICT OF CALIFORNIA  
SOUTHERN DIVISION

J. HOWARD ARNOLD  
Postoffice Box 919  
Berkeley 1, California  
APPELLANT, pro se



# INDEX

AUD IS NOT AN ISSUE IN THIS PROCEEDING	Page 1
OUTLAWED DEBTS ARE INVOLVED IN THIS PROCEEDING	1
SECRECY AND CONCEALMENT ARE NO BAR TO CONFIRMATION	2
SUPERIOR COURT JURISDICTION WAS NOT OUSTED, BUT ABSENT	3
Filing of a divorce action is not legal seizure of property	
Bankruptcy court's jurisdiction in rem is paramount, exclusive	
PARAMOUNT JURISDICTION CANNOT BE LOST BY ABSTENTION	5
Surrender, laches, waiver, or estoppel cannot affect jurisdiction	
Abstention from exercise of jurisdiction is not abandonment	
REFUSAL OF A DISCRETIONARY STAY IS NOT ABANDONMENT	6
STAY OF THE DIVORCE PROCEEDING WAS UNWARRANTED	8
In personam suits may accompany in rem action in another court	
Only interference with the res should be stayed	
THE INTERLOCUTORY JUDGMENT COULD NOT TRANSFER TITLE	11
A declaratory judgment determines rights, orders no action	
Assets cannot be transferred free of creditors' claims	
THE DISTRICT COURT OF APPEAL DECISION WAS A REVERSAL	15
Dissolution of marriage must precede transfer of title to property	
Superior Court lacked jurisdiction in rem to deal with title	
THE PRINCIPLE OF RES JUDICATA DOES NOT BAR CONFIRMATION	17
An order setting aside confirmation is interlocutory, not final	
Fraud by Appellee's counsel vitiated the first appeal in this case	
STARE DECISIS, NOT RES JUDICATA, IS THE APPLICABLE DOCTRINE	19
Wife cannot take community assets in fraud of creditors	
Paramount jurisdiction in rem of bankruptcy court cannot be ousted	
Section 172a, Civil Code, requiring wife's consent, is not law of case	
The issue of validity of the transfer of title was not determined	

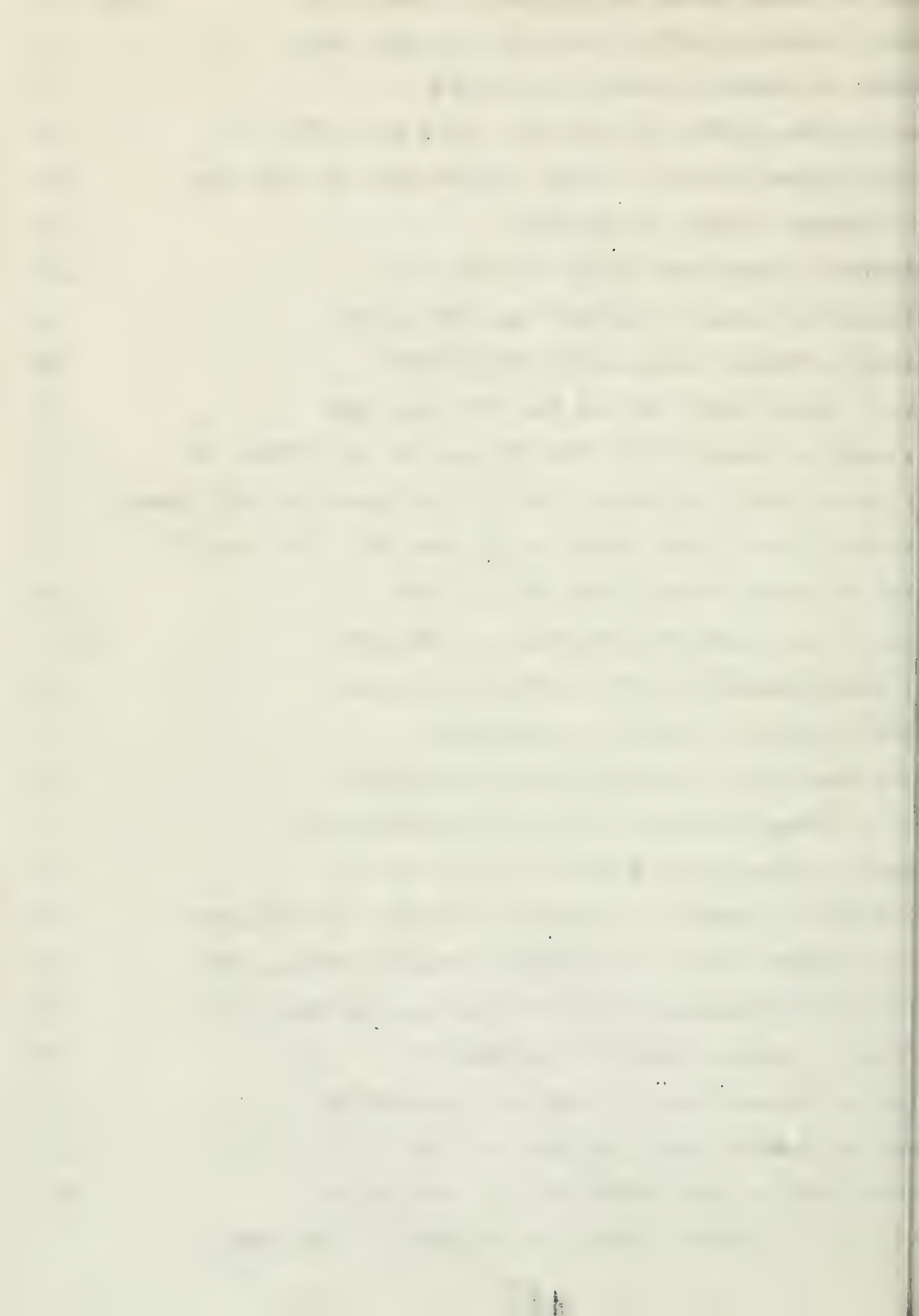


Natl. Ins. Co. v. Yee Lim Shee (1939) 104 Fed. 2nd 688 (CA, 9th)	Page 17
erson v. Eroadwell (1931) 119 Cal. App. 130	20
old v. Arnold (1964) 1 Civil 21272 -21298 (unpublished) DCA Feb. 14	15
old v. Arnold (1964) 326 Fed. 2nd 960 (CA, 9th)	17
of America v. Miantz (1935) 4 Cal. 2nd 322	14
nett v. Mayes (1930) 43 Fed. 2nd 521 (CA, 10th)	8
ch v. Rome Trust Co. (1959) 269 Fed. 2nd 367 (CA, 2nd)	5
man v. Lopereno (1940) 311 U.S. 262 (reversing CA, 9th)	20
ant v. Atlantic C.L. Ry.Co. (1957) 12 Fed. 2nd 569 (CA, 2nd)	8
mbers v. Hodges ( ) 23 Tex. 104	19
nce v. Kobsted (1924) 66 Cal. App. 434	13
eman v. Alcock (1959) 272 Fed. 2nd 618 (CA, 5th)	9
monwealth v. Bradford (1935) 297 U.S. 613	12
ago R.I.P.Ry.Co. v. Owatonna (1941) 120 Fed. 2nd 226 (CA, 8th)	5
ing v. Bryan (1929) 206 Cal. 254	2
is v. Davis (1938) 96 Fed. 2nd 512 (CA, D.C.)	20
ersey Bldg. Corp., In re (1936) 86 Fed. 2nd 456 (CA, 7th)	5
ver v. Nolan (1905) 40 Wash. 459, 82 Pac. 746	9
mers Exch. Natl. Ek. v. Drew (1920) 48 Cal. App. 442	14
st v. Munson Lines (1936) 291 U.S. 1	8
nkell v. Boyd (1895) 106 Cal. 608 at 614	14
l. Exporting Co. v. Star Line (1943) 136 Fed. 2nd 329 (CA, 6th)	12
enfield v. Mather (1930) 14 Cal. 2nd 228	17
ensohn v. K.C.Southern Ry. Co. (1944) 140 Fed. 2nd 950 (CA, 8th)	8, 12
na v. Brietson Mfg. Co. (1932) 62 Fed. 2nd 139 (CA, 8th)	5
nah v. Swift (1932) 61 Fed. 2nd 227 (CA, 11th)	9, 14
rold v. Harrold (1954) 43 Cal. 2nd 77 at 81	4





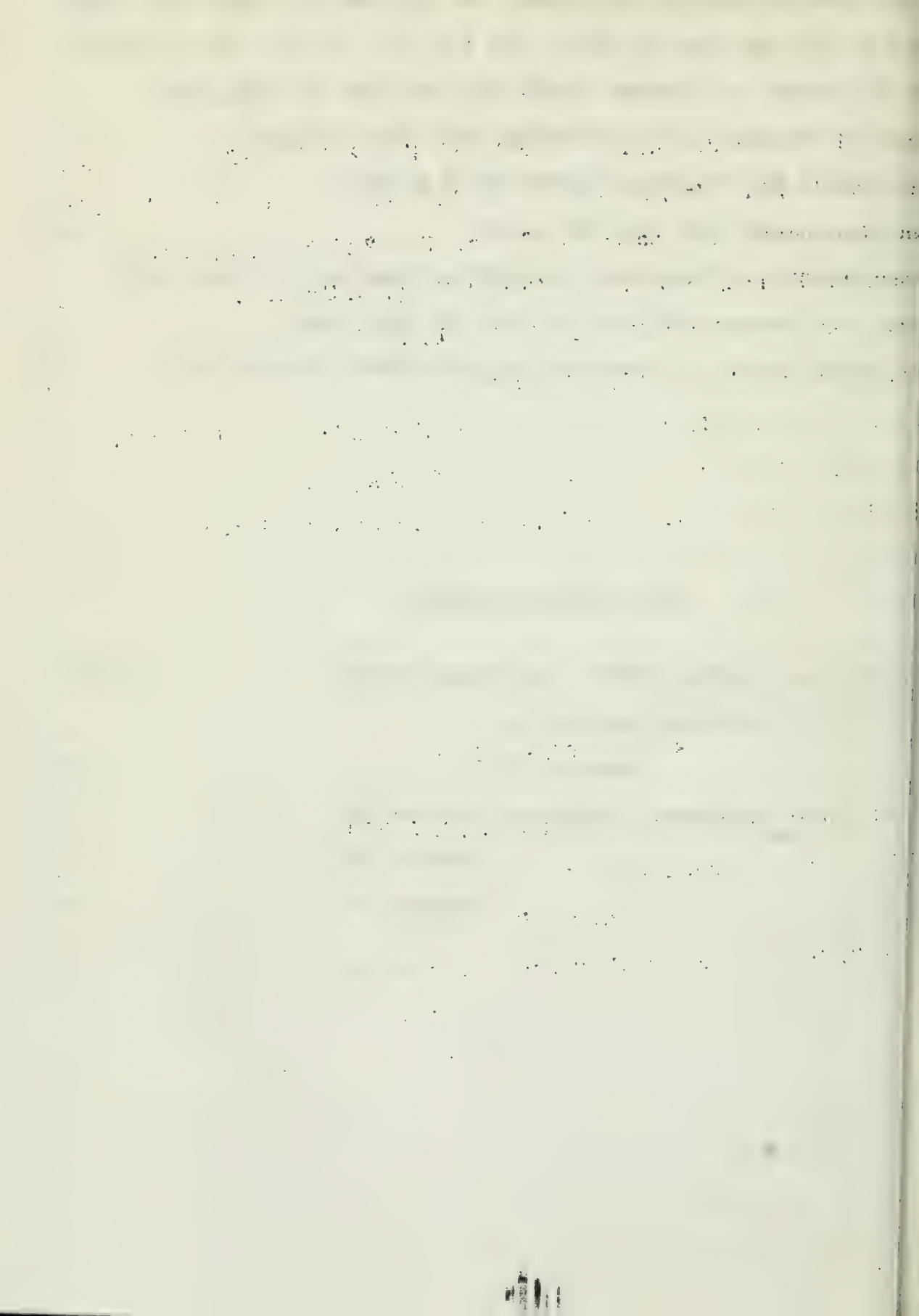
James v. Donald (1937) 51 Fed. 2nd 188 (CA, 3rd)	Page 17
Connell v. Kennedy (1937) 94 Fed. 2nd 487 (CA, 3rd)	17
Schneider v. Dietrich (1895) 110 Cal. 502	2
Line v. Burke (1922) 260 U.S. 226, 24 A L R 1077	10
Bold v. Inland Steel Co. (1943) 136 Fed. 2nd 876 (CA, 7th)	20
rd v. Hough (1872) 43 Cal. 581	3
ndeville v. Canterbury (1943) 318 U.S. 47	10
Clellan v. Carland (1909) 217 U.S. 268 at 281	11
redith v. Winter Haven (1943) 320 U.S. 228	5
ore v. Scott (1932) 55 Fed. 2nd 863 (CA, 9th)	5
tl. Bank. v. Council (1950) 339 Ill. App. 585, 91 NE 2nd 66	5
tl. Autom. Tool Co. v. Goldie (1939) 27 Fed. Supp. 399 (DC, Minn.)	5
ckolls v. Bk. of Calif. (1937) 10 Cal. 2nd 266, 114 A L R 708	6
naud v. Jones (1851) 1 Cal. 488 at 517	13
nton v. Lee (1958) 261 Fed. 2nd 183 (CA, 10th)	2, 9, 14
nn Genl. Casualty Co. v. Pa. (1935) 294 U.S. 189	16
llsbury v. Sup. Ct. (1937) 3 Cal. 2nd 469	17
ioneer Land Co. v. Maddux (1895) 109 Cal. 633	19
rice v. Town of Ruston (1935) 148 So. 512 (La. App.)	18
binsky v. Kosh (1929) 296 Pa. 285, 145 A. 836	18
erson Inc. v. Bullard Co. (1935) 79 Fed. 2nd 192 (CA, 2nd)	17
in v. Montana Power Co. (1936) 84 Fed. 2nd 126 (CA, 9th)	8
msell v. Papenhausen (1948) 79 Fed. Supp. 45 (DC, Cal.)	6
nderson v. Nieman (1941) 17 Cal. 2nd 563	2
ubert v. Seubert (1941) 68 S.D. 195, 299 NW 873	18
condo v. Sup. Ct. (1930) 105 Cal. App. 179	2
uthern Ry.Co. v. Clift (1922) 260 U.S. 316 at 319	20
n Oil Co. v. Burford (1942) 130 Fed. 2nd 10 (CA, 5th)	6



Grace Lawn Mem.Gdns., In re (1958) 256 Fed. 2nd 398 (CA, 9th)	page 12
Ducey v. N.Y. Life Ins. Co. (1941) 314 U.S. 118 at 141, 137 A L R 967,10	
Town of Agawam v. Conners (1947) 159 Fed. 2nd 360 (CA, 1st)	4
Turman v. Turman (1936) 99 SW2nd 946 (Tex. Civ. App.)	10
U.S. v. Bank of N.Y. Trust Co. (1936) 296 U.S. 463	16
U.S. v. Klein (1938) 303 U.S. 276 at 281	12
Vermont Slate Co. v. Tatko Slate Co. (1956) 147 Fed. Supp. 860 (DC, N.Y.)	6
Walrath v. Roberts (1928) 23 Fed. 2nd 32 (CA, 9th)	18
Wayne United Gas Co. v. Owens-Ill. Glass Co. (1936) 300 U.S. 131	20

## STATUTES CITED

Bankruptcy Act, Section 386(2) (11 U.S.C. 786(2))	1,17, 19
Civil Code of California, Section 140	4
Section 172a	20
Code of Civil Procedure of California, Section 157	16
Section 312	1
Section 389	14



I

FRAUD IS NOT AN ISSUE IN THIS PROCEEDING. In his Reply Brief, Appellee's counsel resumes his determined effort to mislead this Court, as he succeeded in doing on the first appeal (No. 18854), by raising a false cry of "fraud". The Court will note, however, that the word does not appear in the Referee's order of Nov. 10, 1964, denying confirmation of the Debtor's Transcript, pp. 31-34), which is being reviewed in this appeal. What is at issue here, as in the prior appeal, is not fraud but jurisdiction in rem and the conflict over it between the Superior Court and the Bankruptcy Court. It is true that the arguments of Appellee's counsel (p. 2, line 17, Reply Brief) invariably allege fraud, concealment, etc.; but the Referee has made no such finding -- which, if made, would be fatal to the Arrangement proceeding. (The 'fraud in procurement' for which Section 386(2), Bankruptcy Act, is invoked is a misnomer, representing not a fatal moral turpitude but merely remediable technical error. Non-disclosure of the Superior Court judgment in these proceedings would be neither fatal fraud, if the judgment transferred the property to Appellee, nor an immaterial irrelevancy if it accomplished no transfer of title.) Appellant, knowing the judgment to be void as to property under settled California law, made no disclosure of it, yet committed no fraud.)

II

OUTLAWED DEBTS ARE INVOLVED IN THIS PROCEEDING. Since the Reply Brief persists in referring to debts "obviously outlawed under the laws of the State of California" (line 3, p. 2) -- an erroneous view arrived at by ignoring Section 312, Code of Civil Procedure and starting





running of the Statute of Limitations when a note is executed, not when  
matures -- it is here noted again that the Referee's order offers no  
conclusion on this absurd question of law. There were no outlawed debts.

### III

#### SECRECY AND CONCEALMENT ARE NO BAR TO CONFIRMATION.

is entirely lawful for a husband to file an original petition under the  
Bankruptcy Act without the knowledge and consent of his wife. Appellee's  
divorce action was filed similarly, and also lawfully. (In reality, she  
began the Arrangement proceedings a few days after they were begun;  
there was no secrecy.) A wife is in privity with her husband; he repre-  
sents both, and she is not a necessary party but may intervene to pro-  
tect her interests if she can show fraud.

Secondo v. Sup. Ct. (1930) 105 Cal. App. 179

Cutting v. Bryan (1929) 206 Cal. 254

The husband must bring all actions regarding the community property.

Sanderson v. Nieman (1941) 17 Cal. 2nd 563

In this proceeding, the wife has indeed intervened -- not by showing any  
fraud against herself, but for the purpose of committing fraud against  
legitimate creditors of the marital community by misusing divorce  
to negate the Federal Bankruptcy Act.

Panton v. Lee, quoted on p. 24, Opening Brief

It should be remarked that this whole proceeding, whose purpose is to  
convert Appellant's promissory notes into notes secured by a Deed of  
Trust, had its origin in Appellee's concealment of her divorce plans  
and her consequent refusal to encumber community property which she  
sought to take free and clear of creditors' claims. She cannot be heard  
to complain of 'secrecy and concealment', in a court of equity.

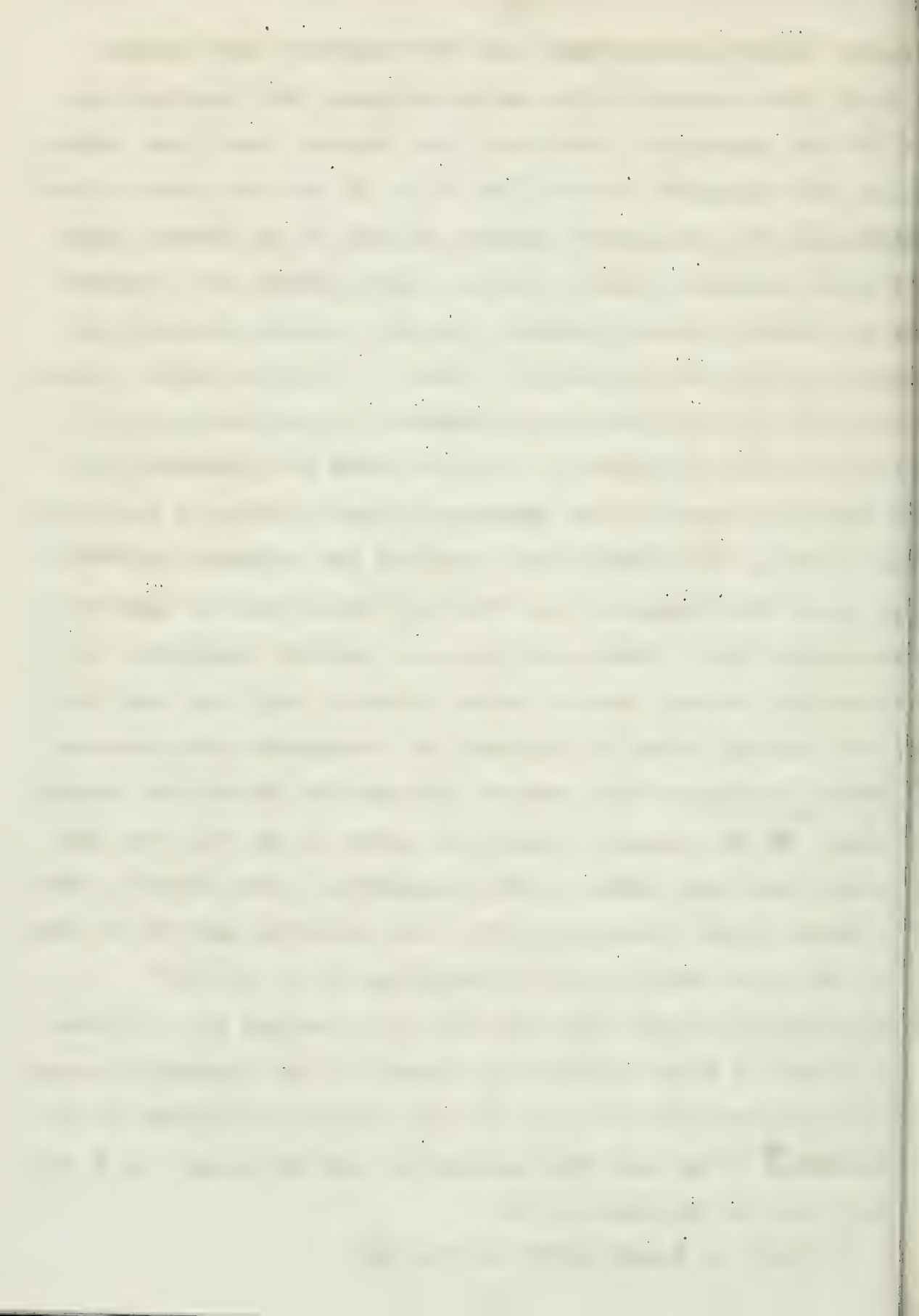


**SUPERIOR COURT JURISDICTION WAS NOT OUSTED, BUT ABSENT.**

The Reply Brief persists in the untrue statements that Appellant contends that the Bankruptcy Court ousted the Superior Court from jurisdiction over the community property (line 22, p. 1), and that Superior Court jurisdiction (in rem, presumably) attached on filing of the divorce action (line 6, p. 3). Appellant contends, however, that (1) Filing of a personal action for divorce does not constitute the legal seizure necessary for jurisdiction in rem, (2) the Superior Court took no other steps to seize or control the property, such as appointment of a receiver, prior to judgment, and (3) if the Superior Court had taken such jurisdiction, it would have been ousted by the Bankruptcy Court on filing of the debtor's original petition, which invokes the paramount and exclusive jurisdiction in rem under the Bankruptcy Act. The Reply Brief cites no authority for the presumption that a State court takes an inviolable jurisdiction in rem over community property when a divorce action is filed, and none can be cited. The Supreme Court of California has consistently ruled otherwise.

Wife's contention: "The fact that the suit for divorce was pending placed all the common property in custody of the law. . the wife would have been entitled at the termination of that action to such a share of the common property owned when the suit was brought as the Court might then have determined to be proper."

The Court's opinion: "The pendency of proceedings for a divorce does not, of itself, interrupt the exercise of the husband's powers. The property does not come into the custody of the Court by the institution of the suit. The husband has still the control of it and full power of disposition of it."





changes in the laws of divorce since 1872 have not affected this ruling.

"When a divorce is pending the power of a husband over the community property exists until the entry of a final decree. (Lord v. Hough . . Chance v. Kibsted . . In re Cummings. . .)"

Harrold v. Harrold (1954) 43 Cal. 2nd 77 at 81

Pellant does not deny the potential jurisdiction in rem given the court by Section 140, Civil Code (pp.3,4 : Reply Brief); the Superior Court may make orders controlling community property BUT in the case at bar it did not --- until after the Bankruptcy Court had seized the property and thus made impossible the making of lawful Superior Court orders in rem. There was no ousting of jurisdiction, no snatching of the res by another court, when the Arrangement petition was filed; the conflict came later, when the Superior Court rendered judgments determining title and possession of property already in custody of the Bankruptcy Court, and used its contempt power to enforce its void orders.

The case at bar is just the reverse of that in Town of Agawam v. Connors, where the State court seized property in a lien foreclosure, after the Bankruptcy Court had relinquished its jurisdiction following a confirmation of arrangement and could not regain it. Lien foreclosure (unlike divorce) is the recognized exception to the rule of paramount bankruptcy-court jurisdiction in rem (Opening Brief, p. 11). The case is on point, and the language quoted is not found in 330 U.S. 845 (the memorandum decision denying certiorari).

"Where state court's jurisdiction in rem has attached first, bankruptcy court has no power to interfere, though Congress could have conferred exclusive jurisdiction even in such cases."

Town of Agawam v. Connors (1947) 159 Fed. 2nd 360 (CA, 1st)

'res snatching' occurred in that case, and should not occur in this one.





PARAMOUNT JURISDICTION CANNOT BE LOST BY ABSTENTION.

The paramount and exclusive jurisdiction in rem conferred by the Bankruptcy Act cannot be lost through acts of bankruptcy officers: trustee, receiver, referee, or district judge. This Court has said:

"Congress has provided for the administration of bankrupt's estate in the bankruptcy court; and after a bankruptcy has supervened, no other court has the power or authority partially to administer or to deplete the estate, by disposing of or impressing a lien upon it or upon any part thereof -- valid prior liens, of course, excepted -- not even in favor of its own receivers."

Moore v. Scott (1932) 55 Fed. 2nd 863 (CA, 9th)

The bankruptcy court cannot surrender its control of the debtor's estate,

Hanna v. Brietson Mfg. Co. (1932) 62 Fed. 2nd 139 (CA, 8th)

nor can its officers lose control by laches, waiver, or estoppel.

C.R.I.P.Ry. Co. v. Owatonna (1941) 120 Fed. 2nd 226 (CA, 8th)

The bankruptcy court may not completely abnegate its jurisdiction,

Natl. Bank v. Council (1950) 339 Ill.App. 585, 91 NE 2nd 66

and may not abstain from assumption of it, although it has discretion to refuse to exercise its authority in every instance a case affords.

Beach v. Rome Trust Co. (1959) 269 Fed. 2nd 367 (CA, 2nd)

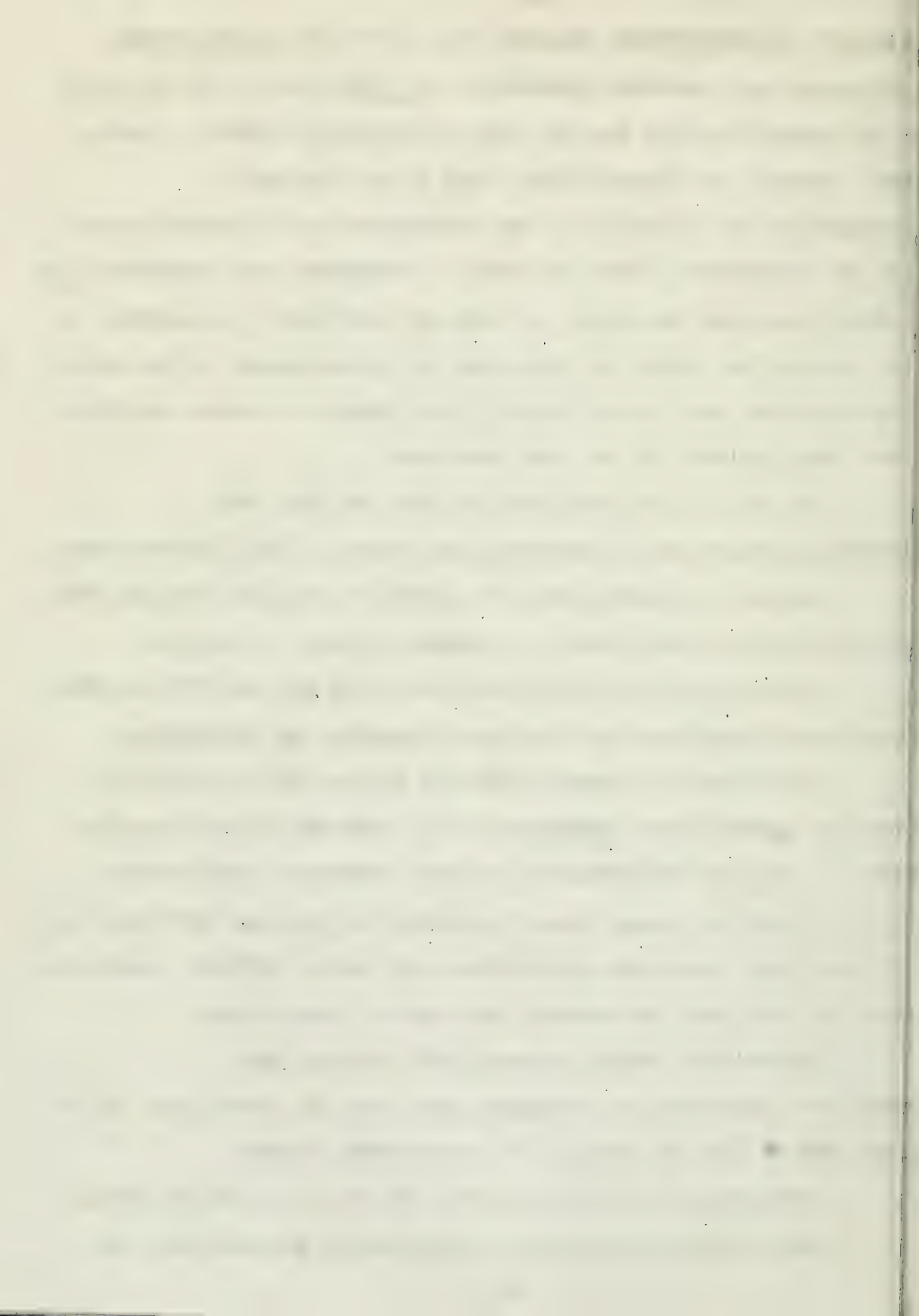
The Federal court must take jurisdiction and decide difficult or uncertain questions of State law, not abandon the case to State courts.

Meredith v. Winter Haven (1943) 320 U.S. 228

However, the jurisdiction is exclusive only over the debtor and his property, and just so far as required for appropriate control.

Natl. Tool Co. v. Goldie (1939) 27 Fed. Supp. 399 (DC, Minn.)

In re Diversey Bldg. Corp. (1936) 86 Fed. 2nd 456 (CA, 7th)



**DENIAL OF A DISCRETIONARY STAY DOES NOT ABANDON JURISDICTION.**  
 The Reply Brief (pages 2, 7) places much weight on the Referee's denial  
 of a stay of the Superior Court orders involving the community property,  
 and contends that for lack of such stay Appellant is now estopped from  
 questioning the void judgments now in effect. However, paramount jurisdic-  
 tion is not that easily lost. The Referee erred in declining jurisdiction  
prem over property in the debtor's possession on filing his petition,

*Sampsell v. Papenhausen* (1948) 79 Fed. Supp. 45 (DC, Cal.)

the Superior Court cannot lawfully seize District Court property.

*Nuckolls v. Bk. of Calif.* (1937) 10 Cal. 2nd 266, 114 ALR 708

stay of action in another <sup>court</sup> is proper unless the right thereto is clear  
 and unequivocal; in a doubtful case, comity requires denial.

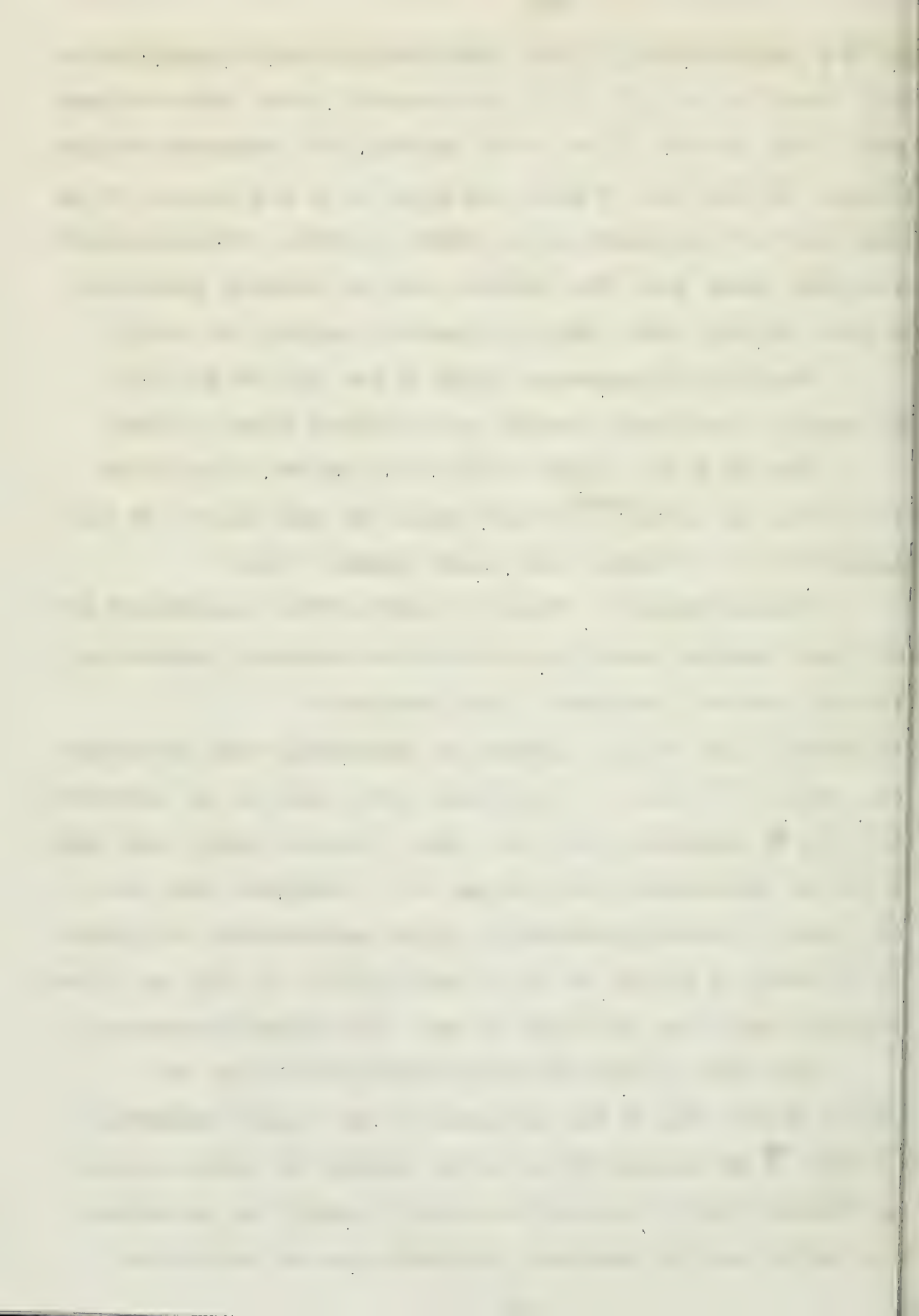
*Vermont Slate Co. v. Tatko Co.* (1956) 147 Fed. Supp. 860 (DC, N.Y.)

However, such denial is merely an incident in the exercise of jurisdiction,  
 and a final and complete disclaimer of such jurisdiction.

"A federal court does not impugn its jurisdiction when in the exer-  
 cise thereof it denies a discretionary writ, such as the extraordi-  
 nary writ of injunction, especially when a federal equity court with-  
 holds its discretionary writ because of . . . perplexities that arose . . .  
 and when a discretion afforded by equity jurisprudence is exercised  
 as a matter of comity, so as to avoid friction in state and federal  
 relations under our dual form of state and national governments."

*Sun Oil Co. v. Burford* (1942) 130 Fed. 2nd 10 (CA, 5th)

The Referee in the case at bar, uncertain of his court's jurisdiction,  
 granted a stay of the Superior Court order evicting the debtor; Appellee  
 and the District Court of Appeal now seek to nullify that jurisdiction  
 on the ground it was not exercised, but such argument is frivolous.



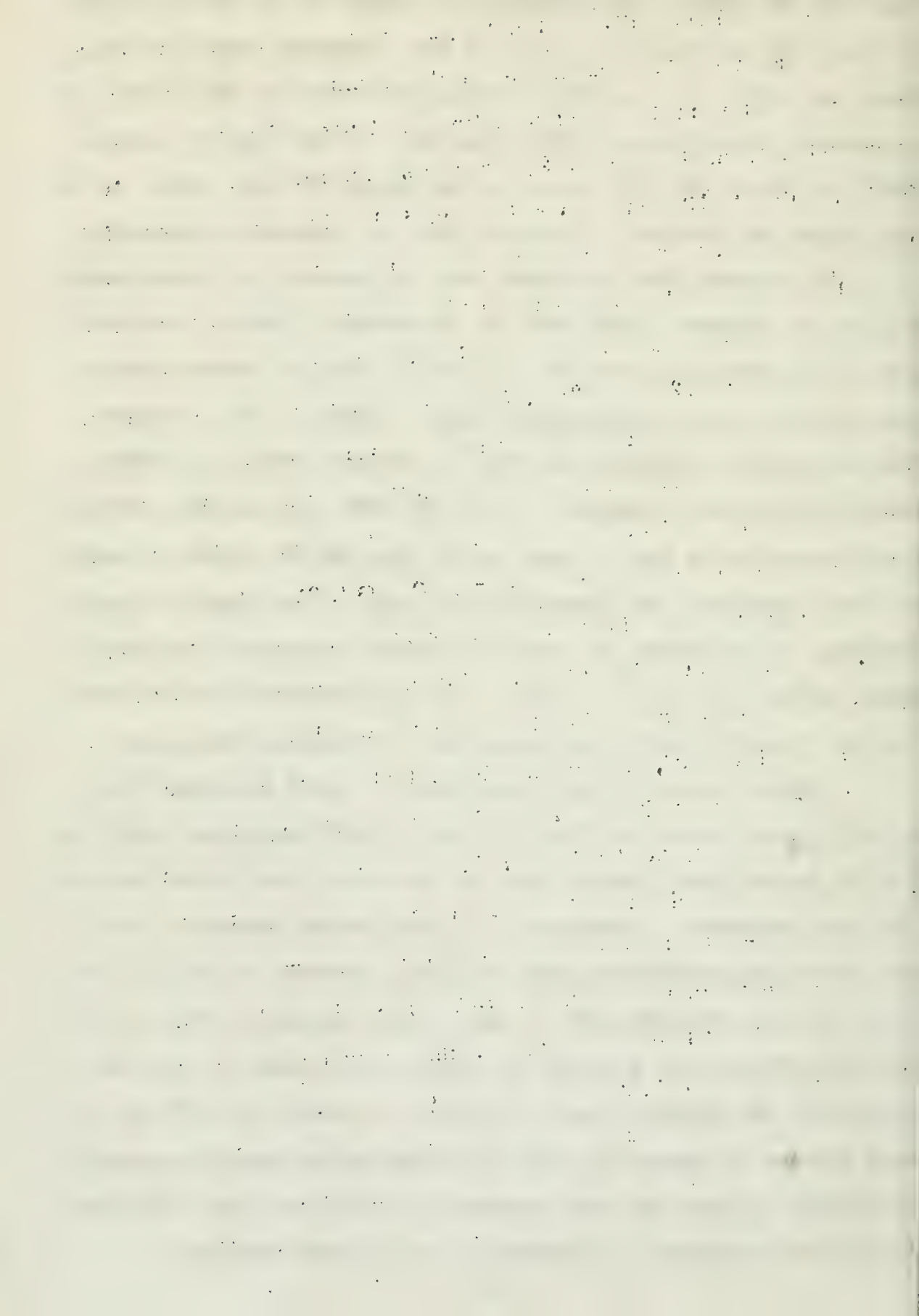


not true as alleged (Reply Brief, p. 2, lines 10, 15) that the Bankruptcy Court did not take possession of the community real property. Appellant, as Debtor in Possession acting as trustee for the Court, did take possession from June 19, 1962, when his original debtor's petition was filed, to March 20, 1963, when he was jailed by void orders of the Superior Court; the Referee, of course, took no possession personally.

It is untrue that Appellant made no attempt to prevent interference by the Superior Court with the Bankruptcy Court's possession of the res (Reply Brief, p. 2, line 12; p. 7, line 7). When it became apparent that the Superior Court contemplated illegal seizure of the property by awarding immediate possession (as well as ultimate title) to Appellee, Appellant filed written objections on Oct. 15, 1962, pleading the arrangement with creditors in bar to such award. On Oct. 22, 1962, he made further oral objection to the jurisdiction in rem of the Superior Court, at a hearing on re-opening the case for further testimony, but Judge Croninger replied "I am not going to pay any attention to the proceedings in the Federal court", and signed the Interlocutory Judgment.

When Superior Court proceedings to evict Appellant from the debtor's estate began, he filed on Feb. 13, 1963, and urged orally at the Feb. 15 hearing the objection that the Superior Court lacked jurisdiction in rem necessary to issuance of a quasi in rem exclusion order, but the order was nevertheless made by Judge Bostick on Feb. 15. The Referee denied on Feb. 21, 1963, a stay of the exclusion order, as did District Judge Weigel on Feb. 28. A petition for a writ of prohibition was denied by the District Court of Appeal on March 18, 1963. At the contempt hearing of March 20, 1963, Appellant again raised the question of jurisdiction in rem, but was sentenced to 25 days in jail. The Superior Court has had several opportunities 'to pass upon its jurisdiction'.





AY OF THE DIVORCE PROCEEDINGS WAS UNWARRANTED. The Reply  
 ef suggests (p. 7, lines 7, 12, 15) that the divorce proceedings should  
 ve been stayed, either by the Superior Court or by the Bankruptcy  
 urt, and that Appellant was remiss in not securing such a stay. He  
 ask both courts to stay interference with the res in custody of the  
 kruptcy Court, without success, and also urged the jurisdictional lack  
 briefs and petitions to this Court, the District Court of Appeal, the  
 reme Court of California, and the Supreme Court of the United States.  
 o to no avail. Interference with the res should be stayed,

Sain v. Montana Power Co. (1936) 84 Fed. 2nd 126 (CA, 9th)

Bryant v. A.C.L.Ry.Co.(1937) 92 Fed. 2nd 569 (CA, 2nd)

Barnett v. Mayes (1930) 43 Fed. 2nd 521 (CA, 10th)

the discretionary stay should be denied by the Bankruptcy Court if  
 other suit does not encroach on its exclusive jurisdiction in rem.

Foust v. Munson Lines (1936) 299 U.S. 77

stay by the State court is also discretionary.

Connell v. Walker (1933) 291 U.S. 1

personam suits, not involving the debtor's estate, cannot be stayed  
 all, but may proceed to judgment.

Gutensohn v. K.C.S. Ry. Co. (1944) 149 Fed. 2nd 950 (CA, 8th)

"..the Trustee is not bound..by the prior state court proceed-  
 ings..merely because the (Debtor) was a party defendant in the  
 prior litigation. Only in a limited situation will the Trustee be  
 foreclosed. This will not include a mere in personam proceeding,  
 for if .. the judgment was a personal one against the (Debtor),  
 then it was not binding on the (Debtor's) estate, because the Trus-  
 tee was not made a party defendant..to be binding the prior pr



ceeding must have been in rem or quasi in rem."

Coleman v. Alcock (1959) 272 Fed. 2nd 618 (CA, 5th)

divorce action, though sometimes said to be in rem as regards marital status, is not in rem as regards community property; it is in personam.

"The action was solely for the purpose of procuring a judgment of divorce between the parties. . . The primary and substantive subject of litigation in a suit for divorce is the personal relation of the parties, and (determination of) their rights to the community property is but incidental thereto."

Kirschner v. Dietrich (1895) 110 Cal. 502

"It will not be gainsaid that an action for divorce is a purely personal action. Nothing is sought to be affected but the marital status of the husband and wife. The distribution of property in such an action is incidental."

Dwyer v. Nolan (1905) 40 Wash. 459, 82 Pac. 746

legislation or court decision has recognized the avowedly mercenary nature of some divorce suits, so far as to make them in rem actions against community assets in fraud of husband and creditors; the rule is the contrary, and all divorce suits are considered to be in personam.

Hannah v. Swift (1932) 61 Fed. 2nd 307 (CA, 9th)

Panton v. Lee (1958) 261 Fed. 2nd 183 (CA, 10th)

is, in the case at bar, neither need nor authority existed to stay the divorce action itself, but only to stay interference with the res arising from the Superior Court's enforcement of its void judgments, beginning with the eviction order of Feb. 15, 1963. Had the Referee granted a stay of all proceedings in rem against the community assets in the Superior Court, on filing of the debtor's petition June 1, 1962, that Court could nevertheless have proceeded to a personal judgment in the divorce action.





judgment, of course, could not involve (but might affect -- see p. 22, ening Brief) the community assets, or nullify the rights of creditors.

"Complaint is made that it was an abuse of judicial discretion for the trial court to proceed to trial..because the United States District Court for the Northern District of Texas had made and entered an order...restraining appellee..from prosecuting any proceeding in any other court, for the purpose of fixing a lien or foreclosing upon, or taking possession of any property involved in the petition for review of the referee's order, pending in the United States District Court. We are of the opinion that the..court..as between appellant and appellee, had the unquestioned right to proceed to trial, as was done, regardless of the order of the United States District Court. We are of the opinion that it was not error for the..court to enter judgment partitioning the community property, even though it was involved in the bankruptcy case, complaint likewise being made as to this action of the trial court."(emphasis added)

Turman v. Turman (1936) 99 SW 2nd 946 (Tex. Civ. App.)

judgment is in accord with the principle that a Federal court may t enjoin State court proceedings in personam, but only those in rem.

Toucey v. N.Y. Life (1941) 314 U.S. 118 at 141, 137 ALR 967

versely, State court actions in personam may proceed simultaneously th Federal Court actions in rem, without interference.

Kline v. Burke (1922) 260 U.S. 226, 24 ALR 1077

Mandeville v. Canterbury (1943) 318 U.S. 47

the Turman case, the Texas trial court respected the limits of its n jurisdiction, as imposed by the Bankruptcy Act; it did not seize the s, imprison the trustee, or defraud the creditors, but simply defined e personal rights of the parties in consequence of divorce.





# INTERLOCUTORY JUDGMENT COULD NOT TRANSFER TITLE.

The Superior Court had jurisdiction in personam, but not in rem over community property. It could lawfully grant divorce and decree that the husband's rights in the property be given to the wife on dissolution of marriage by Final Decree. That Court had no jurisdiction, however, to effect an immediate transfer of title and possession to the wife, in defiance of Federal law, or to ignore California law by refusing to consider the debts of the husband and the rights of creditors in the community property. The Bankruptcy Court, moreover, acquiesced by inaction.

"... the (Federal) Court had practically abandoned its jurisdiction over a case of which it had cognizance, and turned the matter over for adjudication to the State court. This, it has been steadily held, a Federal court may not do."

*McClellan v. Carland* (1909) 217 U.S. 268 at 281

Withholding the exercise of Federal court power is proper, up to a point, but Federal abdication in deference to State usurpation must be avoided.

"Finally, although there is no doubt that a judgment in the state court upon the issues there involved will be binding upon the parties... (and)... even if the power to proceed with this litigation is conceded to the state court, it may not, as an incident thereto, take action which will impinge upon the functions of the national tribunal under the laws relating to bankruptcies. The federal court now has paramount and exclusive jurisdiction of the proceeding... By allowing these issues to be tried in the state court, the bankruptcy tribunal has yielded no whit of its essential powers. The federal court has still full authority to perform the functions which are entrusted to it by Congress. Therefore, it was not error to



permit the state courts to proceed with the litigation there pending."

In re Terrace Lawn (1958) 256 Fed. 2nd 398 (CA, 9th)

This Court agrees, therefore, that the State court may determine the issues proper to a divorce action, and bind the parties by its judgment, including the adjudication of personal rights in property held in custodia legis by the bankruptcy court, but without controlling the property.

Genl. Exporting Co. Star Line (1943) 136 Fed. 2nd 329 (CA, 6th)

U.S. v. Klein (1938) 303 U.S. 276 at 281

rendition of a declaratory judgment, ordering no action but simply determining rights of the parties in the res, constitutes no interference with the jurisdiction in rem of the bankruptcy court. Specifically, a declaratory judgment against the trustee does not interfere with the debtor and his property, over which the Federal court's jurisdiction is exclusive.

Gutensohn v. K.C. Southern Ry. Co., *supra*

Commonwealth v. Bradford (1935) 297 U.S. 613

proper Interlocutory Judgment of Divorce is a declaratory judgment, defining the personal rights of the litigants but ordering no action such as transfer of title to community assets; it is tentative, and withholds action pending a Final Judgment which may never eventuate.

In the divorce action Arnold v. Arnold, what was 'awarded' to the wife was not the community property --that is, fee title, free of creditors' claims-- but only the husband's rights in it (his half-interest, to be added to hers, but both interests subject to community debts).

"The wife's interest in the community property could only become vested and severable upon a dissolution of the community and there was no dissolution. . . Until such dissolution, either by divorce or by the death of one spouse, the wife's interest was an inchoate one and not such as to form the basis for an action to quiet title."





that case, as in this one, the law was circumvented, and

"...plaintiff sought to enforce an indeterminate equitable interest against the property."

There is no legal theory by which the 'award' of the Interlocutory Judgment can transfer title to community assets free of creditors' claims, or anything more than a tentative right to the husband's residual interest

"It would be a startling doctrine to hold that, on the death of the wife, one half of the common property immediately vested in the children of the marriage, without reference to the payment of the debts contracted by the husband for the benefit of the joint community...The common property should be and is, not one half but the whole, a security for the payment of debts contracted for the common benefit...and neither the heirs of the wife nor of the husband have any interest, except in the portion which shall remain after the payment of such debts."

Panaud v. Jones (1851) 1 Cal. 486 at 517

would be doubly startling if not one half but both halves vested in the community without benefit of either death or divorce to dissolve the community.

"...when the community is dissolved...by a decree of divorce, the authority of the court to assign all the community property to one of the spouses must be taken and construed as meaning the residue of such property after the payment of the existing debts of the husband, contracted upon the faith of such property...The community property to be distributed may well be considered (as in case of partnership, to which in many respects (marriage) bears a close resemblance) as the residue which remains after the discharge of the community obligations.





"Had the husband by a voluntary conveyance transferred all of the community property to his wife, leaving himself without means, it is not to be doubted but that the property so transferred would have been liable to his creditors for existing debts.

When the court assigned all the property to (creditor) it, in effect, did what in law the husband should have done under like circumstances, and the conclusion is reached that in such a case, where all the community property has been assigned to the wife, leaving the husband without separate property, the property so assigned is taken subject to the equitable claim of . . . creditors, whose demands are due . . . on account of credit extended during the existence of the marital relation to the husband for the benefit of the community.

. . . Under such circumstances every moral consideration prompts the satisfaction of the demand from the community property. And we are of opinion the moral and legal obligations go hand in hand."

Frankel v. Boyd (1895) 106 Cal. 608 at 614

award of assets without proper allowance for debts is an obvious violation of Section 389, Code of Civil Procedure, since the creditors are indispensable parties to an action seeking to nullify their rights. The obligation to pay the debts is an inseparable accompaniment to the privilege of taking title to the assets, and cannot be escaped.

Bank of America v. Mantz (1935) 4 Cal. 2nd 322

Farmers' Exch. Natl. Bank v. Drew (1920) 48 Cal. App. 442

Hannah v. Swift (CA, 9th), supra; quoted, p.15, Opening Brief

Panton v. Lee (CA, 10th), supra; quoted, p. 24, Opening Brief

The Interlocutory Judgment could not transfer title, free of creditors' claim.



THE DISTRICT COURT OF APPEAL DECISION WAS A REVERSAL.

The Reply Brief objects (p.8) to the alleged 'misstatement of fact' that the immediate transfer of title purportedly contained in the Interlocutory Judgment's 'award' was 'reversed by modification' (Opening Brief, p. 20).

It is true that the Interlocutory Judgment 'as so modified' was affirmed, but it is also true that the modification was an effective reversal of the apparent transfer of title on which the Referee bases his withholding of confirmation. It is irrelevant to this appeal that the provisions granting alimony, child custody and support, and even possession of the community real property, were affirmed. The Referee's concern arises from the fact that the Interlocutory Judgment of Oct. 22, 1962, preceded the confirmation of Arrangement granted on Oct. 30, 1962. If the Judgment effected a valid immediate transfer of title from Appellant to Appellee, the Bankruptcy Court lost its principal asset from the debtor's estate, making impossible the proposed Arrangement. If, however, the transfer of title was either invalid or not immediate, the Arrangement could be affirmed. By holding that the property disposal provisions shall be effective only on entry of a final decree of divorce, the District Court of Appeal nullified the Superior Court's attempt at an immediate transfer of title and removed the obstacle to confirmation of the Arrangement.

This portion of the decision (quoted in pertinent part on pp. 18, 19, 20, Opening Brief) is based entirely on California law, without reference to either jurisdiction in rem or the Bankruptcy Act, but is correct.

The portion of the decision affirming the Superior Court order of Feb. 15, 1963, excluding Appellant from his debtor's estate, is correct, rejecting on frivolous grounds the paramount and exclusive jurisdiction in rem of the bankruptcy court and suggesting that the Super-





r Court had taken previously the necessary jurisdiction in rem and  
uld not be divested of it by the proceedings in bankruptcy court. The  
clusion order, made under Section 157, Code of Civil Procedure, is  
quasi in rem order necessitating jurisdiction in rem.

"An action is in rem where relief demanded requires control of  
the res, even though seeking also to establish personal liability."

U.S. v. Bank of N.Y. Trust Co. (1936) 296 U.S. 463

e jurisdiction in personam held by the trial judge was insufficient to  
oport the exclusion order, which sought to control the property.

"Where the judgment sought is strictly in personam. . for an injunc-  
tion compelling or restraining action by the defendant both a state  
court and a federal court. . . may proceed with the litigation. . . But  
if the two suits are in rem or quasi in rem, requiring that the  
court or its officer have control of the property which is the sub-  
ject of the suit in order to proceed with the cause and to grant  
the relief sought, the jurisdiction of one court must of necessit  
yield to that of the other. . ."

Penn Genl. Casualty Co. v. Pa. (1935) 294 U.S. 189

isdictional law thus forbids both the transfer of title ('award' of the  
roperty) and eviction of the debtor from his estate, while divorce law  
bids the transfer of title in fraud of creditors prior to Final Decree.  
e District Court of Appeal contention that the Superior Court had jur-  
isdiction in rem to transfer title and evict Appellant is ~~incorrect~~ and not  
mpatible with settled law establishing paramount jurisdiction in rem in  
e bankruptcy court. The Certificate of Nonpublication indicates that the  
urt was not aware that its decision "involves a new and important  
ue of law, a change in an established principle of law", disqualifying  
e decision for non-publication under Rule 976, Calif. Rules of Court.





THE PRINCIPLE OF RES JUDICATA DOES NOT BAR CONFIRMATION.  
 There is no place in this appeal for the application of the doctrine of res judicata, for several reasons:

- (1) The judgment in the prior appeal (No. 18854) affirming the setting aside of the confirmation dealt with a Referee's order that was interlocutory, not final.
- (2) The judgment was obtained by fraud upon this Court by counsel for Appellee, by misrepresenting the basis for the Referee's order.
- (3) The causes of action in the two appeals are not the same, and the jurisdictional question has not yet been settled finally.

It is well established that an interlocutory or provisional judgment, such as the setting aside of a confirmation for remediable technical error under Section 386(2), Bankruptcy Act, is no bar to further action; to be such bar, the first judgment must put an end to the case.

*Am. Natl. Ins. Co. v. Yee Lim Shee* (1939) 104 Fed. 2nd 688 (CA, 9th)

*Holmes v. Donald* (1936) 84 Fed. 2nd 188 (CA, 5th)

*Kannel v. Kennedy* (1937) 94 Fed. 2nd 487 (CA, 3rd)

*Ryerson Inc. v. Bullard Co.* (1935) 79 Fed. 2nd 192 (CA, 2nd )

*Pillsbury v. Sup. Ct.* (1937) 8 Cal. 2nd 469

*Greenfield v. Mather* (1939) 14 Cal. 2nd 228

That this Court's opinion in the first appeal (No. 18854)

*Arnold v. Arnold* (1964) 326 Fed. 2nd 960 (CA, 9th)

reads like a final judgment is due entirely to fraud by Appellee's counsel in misrepresenting to this Court the basis for the Referee's order:

"...the basic question to be decided was not whether the... Interlocutory Judgment... was a valid transfer of title... but one of fraud and concealment... by listing outlawed... debts... and... concealing the



bankruptcy proceedings from his wife. . "

Appellee's Reply Brief, No. 18854, p. 3. Filed Nov. 20, 1963  
However, in an order served on Appellant June 21, 1963, denying a mandatory injunction to Appellee to conserve the debtor's estate, her counsel made the conflicting and incompatible statement that

"...said real property...was heretofore awarded to FRANCES KELLY ARNOLD...in the Superior Court...and objection being made by counsel...to the jurisdiction of this Court."

Order in Case No. 68024, U.S. District Court  
The Referee's order on appeal (pp. 32, 33, Clerk's Transcript) makes it clear that the question at issue, then as now, was not fraud but validity of the Interlocutory Judgment as a transfer of title; or, alternatively stated, whether the District Court lacked jurisdiction in rem -- as was successfully contended by Appellee's counsel at the hearing of June 20, 1963, and denied with equal success in his Reply Brief 5 months later.

A judgment obtained by fraud cannot be pleaded as res judicata.

Seubert v. Seubert (1941) 68 S.D. 195, 299 NW 873

Rubinsky v. Kosh (1929) 296 Pa. 285, 145 A 836

To be effective in bar, a judgment must be definitive, deciding all points in issue between the parties -- such as jurisdiction in rem in this appeal.

Price v. Town of Ruston (1933) 148 So. 512 (La. App.)

So, identity of subject-matter in the two appeals is required; they must involve the same cause of action. This appeal is concerned with confirmation of an Arrangement, the first appeal with correction of remediable technical error in procurement through a temporary setting-aside of a confirmation granted before the jurisdictional issue was raised.

Walrath v. Roberts (1928) 23 Fed. 2nd 32 (CA, 9th)

The first appeal arose from the non-disclosure of the Interlocutory Judgment.





ent and its purported transfer of title and concomitant loss of District court jurisdiction in rem; the merits of the Arrangement were not at issue, supposedly, except in curing the 'fraud in procurement', under section 386(2), Bankruptcy Act, such error being presumed remediable. On this appeal, the Interlocutory Judgment having been disclosed, the merits of the Arrangement come up for consideration; the Referee finds the Interlocutory Judgment valid, barring confirmation, while Appellant contends there was no transfer of title (both because it was untimely by state divorce law and because the Superior Court lacked jurisdiction in rem the Interlocutory Judgment having been reversed in part by the District Court of Appeal for the first of these reasons) and confirmation is not ordered. That part of the District Court of Appeal decision affirming the void Superior Court exclusion order is itself void, and cannot properly be pleaded in bar of confirmation under the res judicata doctrine.

Chambers v. Hodges ( ) 23 Tex. 104

Pioneer Land Co. v. Maddux (1895) 109 Cal. 633

## XI

ARE DECISIS, NOT RES JUDICATA, IS THE APPLICABLE DOCTRINE. There is no case in the appellate records where a California divorce court has given the assets of the marital community to the wife, the debts to the husband, and nothing to the creditors--except Arnold v. Arnold! There is no case where the Federal courts have decided a contest for assets between a wife and a bankruptcy trustee in favor of the wife except Arnold v. Arnold! The District Court of Appeal decision -- the only original appellate holding on the question of jurisdiction in rem -- is void on that point; it has no foundation in prior court decisions, but it violates without justification the long-settled principle that the jurisdiction





in rem of the Federal courts of bankruptcy is paramount and exclusive, not subject to surrender by court or debtor, and incapable of being seized by other courts.

The wife's consent is unnecessary to validate a deed if the husband holds the property as a trustee, not in his own right.

Anderson v. Broadwell (1931) 119 Cal.App.130

The mention of Section 172a, Civil Code, in the decision of this Court in the prior appeal was dictum, and need not be regarded as 'law of the case'. Error and injustice are correctible by a second appeal.

Davis v. Davis (1938) 96 Fed.2nd 512 (CA, D.C.)

Lebold v. Inland Steel Co. (1943) 136 Fed.2nd 876 (CA, 7th)

Southern Ry. Co. v. Clift (1922) 260 U.S. 316 at 319

Bankruptcy courts, unlike others, may grant a rehearing at any time, permitting a new appeal to be taken on an undetermined issue.

Wayne United Gas Co. v. Owens-Ill. Glass Co. (1937) 300 U.S. 131

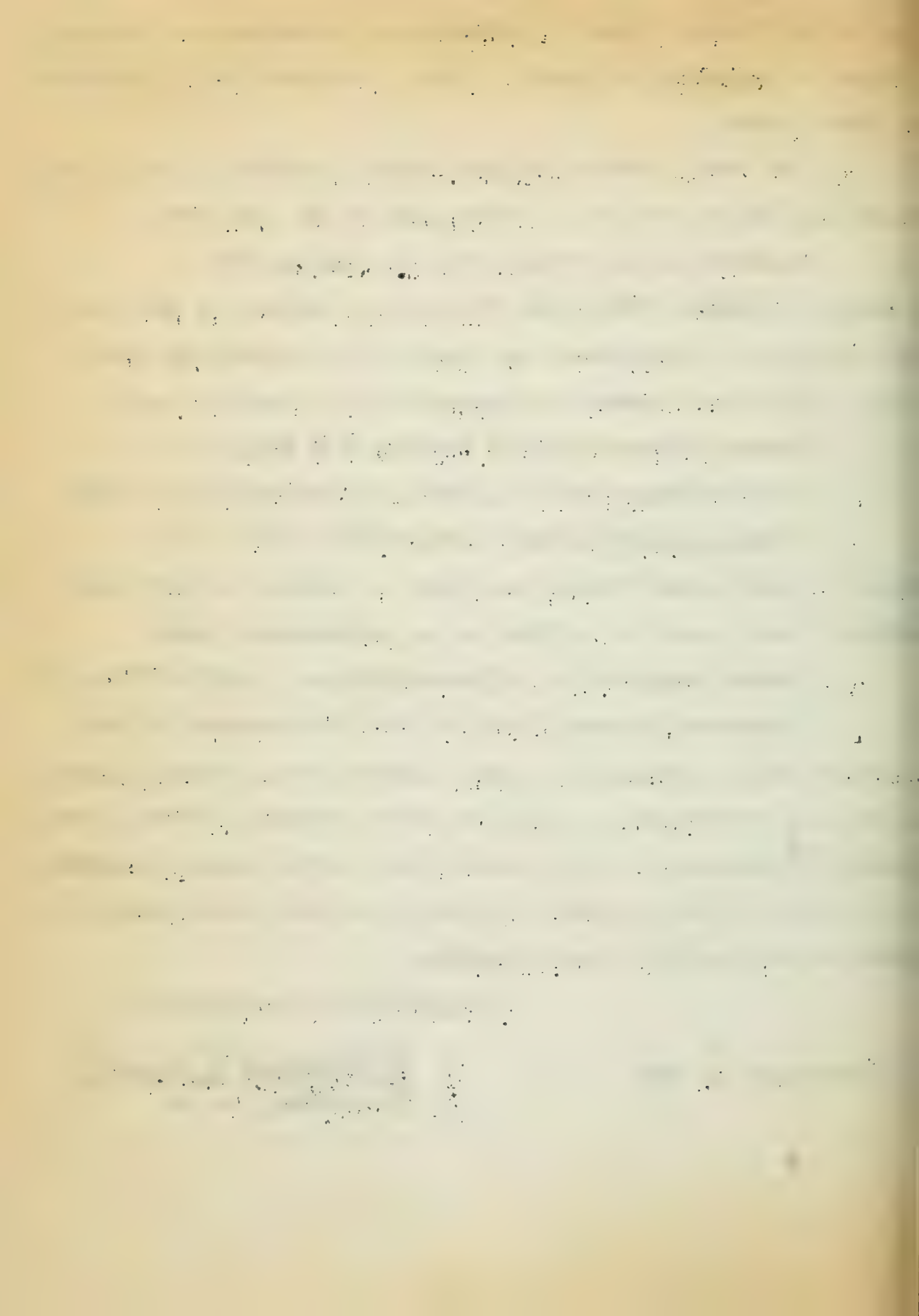
Bowman v. Lopereno (1940) 311 U.S. 262 (reversing CA, 9th)

The District Judge's affirmation of the Referee's order denying confirmation for lack of jurisdiction in rem should be reversed by this Court, to permit the impression of an equitable lien on the parties' community real property and thus guarantee payment of the valid debts incurred by appellant for the benefit of the community.

RESPECTFULLY SUBMITTED,

Dated: November 17, 1965.

*J. Howard Arnold*  
Appellant, pro se



UNITED STATES COURT OF APPEALS  
FOR THE NINTH CIRCUIT

J. HOWARD ARNOLD, Debtor in Possession

VS.

APPELLANT

FRANCES K. ARNOLD

APPELLEE

A P P E L L A N T ' S   O P E N I N G   B R I E F

Appeal from the

UNITED STATES DISTRICT COURT for the  
NORTHERN DISTRICT OF CALIFORNIA  
SOUTHERN DIVISION

J. HOWARD ARNOLD

Postoffice Box 919

Berkeley 1, California

APPELLANT, pro se



No. 20107

UNITED STATES COURT OF APPEALS  
FOR THE NINTH CIRCUIT

J. HOWARD ARNOLD, Debtor in Possession

VS.

APPELLANT

FRANCES K. ARNOLD

APPELLEE

A P P E L L A N T ' S O P E N I N G B R I E F

Appeal from the  
UNITED STATES DISTRICT COURT for the  
NORTHERN DISTRICT OF CALIFORNIA  
SOUTHERN DIVISION

J. HOWARD ARNOLD  
Postoffice Box 919  
Berkeley 1, California

APPELLANT, pro se



THE UNIVERSITY OF CHICAGO  
DEPARTMENT OF THE HISTORY OF ARTS  
AND ARCHITECTURE

THE UNIVERSITY OF CHICAGO  
DEPARTMENT OF THE HISTORY OF ARTS  
AND ARCHITECTURE  
CHICAGO, ILLINOIS 60637

CHICAGO, ILLINOIS 60637

CHICAGO, ILLINOIS 60637

CHICAGO, ILLINOIS 60637

JURISDICTIONAL BASIS	Page 1
STATEMENT OF THE CASE	2
SPECIFICATION OF ERRORS	6
SUMMARY OF ARGUMENT	7
ARGUMENT	8
Part A: The Interlocutory Judgment of Divorce does not bar confirmation.	8
I. A Superior Court does not take jurisdiction in rem over community property on filing of a divorce action	8
II. A U.S. District Court takes jurisdiction in rem by legal seizure of a debtor's property, including community assets, on filing of his original petition under the Bankruptcy Act. That jurisdiction is exclusive.	9
III. Jurisdiction in rem can be held by only one court at a time; in case of conflict, the Bankruptcy Act gives the U.S. District Court paramount and exclusive jurisdiction.	10
IV. After Federal bankruptcy court seizure, judgments taken against property in another court are null and void for lack of jurisdiction in rem and no new judgment liens may attach to the property.	12
V. Jurisdiction in rem, once taken, may not be relinquished by a court of bankruptcy over the protest of the debtor; the court may not abstain from assumption and exercise of its paramount and exclusive jurisdiction.	14
VI. A divorce judgment purporting to award community assets to the wife, in fraud of creditors, and community debts to the husband, is contrary to California law, and void.	15
VII. Property disposal provisions in an Interlocutory Judgment of divorce are preliminary and tentative, taking effect only if and when the marriage is dissolved by Final Judgment of Divorce, and subject to revision.	17



Part A (continued):

VIII. The District Court of Appeal decision that the Superior Court held jurisdiction in rem over the community property after filing of Appellant's original petition under the Bankruptcy Act is erroneous, and should not be followed by this Court. Other decisions do not support it. 19

IX. The Tenth Circuit decision in the case of Panton v. Lee correctly applies established jurisdictional law to the divorce-bankruptcy conflict; it should be followed here. 24

Part B: This Court's prior decision does not bar confirmation. 28

X. Affirmation on appeal of the Referee's order setting aside confirmation of a previous Arrangement was erroneous, and rested on an incorrect speculative view of the case. 26

XI. The scheduled debts were not outlawed, and no finding of the District Court holds them to be; if they were, the Arrangement would fall without use of Section 172a, Civil Code, and the proceeding would be dismissed. 29

XII. Section 172a, Civil Code, is not properly a part of the law of this case, and cannot be invoked to bar an Arrangement by requiring the consent of a debtor's wife to encumbrance of real property by District Court order. 31

XIII. Affirmation on appeal of the application of Section 386(2), Bankruptcy Act, not only does not bar confirmation of arrangement, but serves only to correct technical errors and clear the way for confirmation of a new plan; it is not a terminal step. 33

CONCLUSIONS

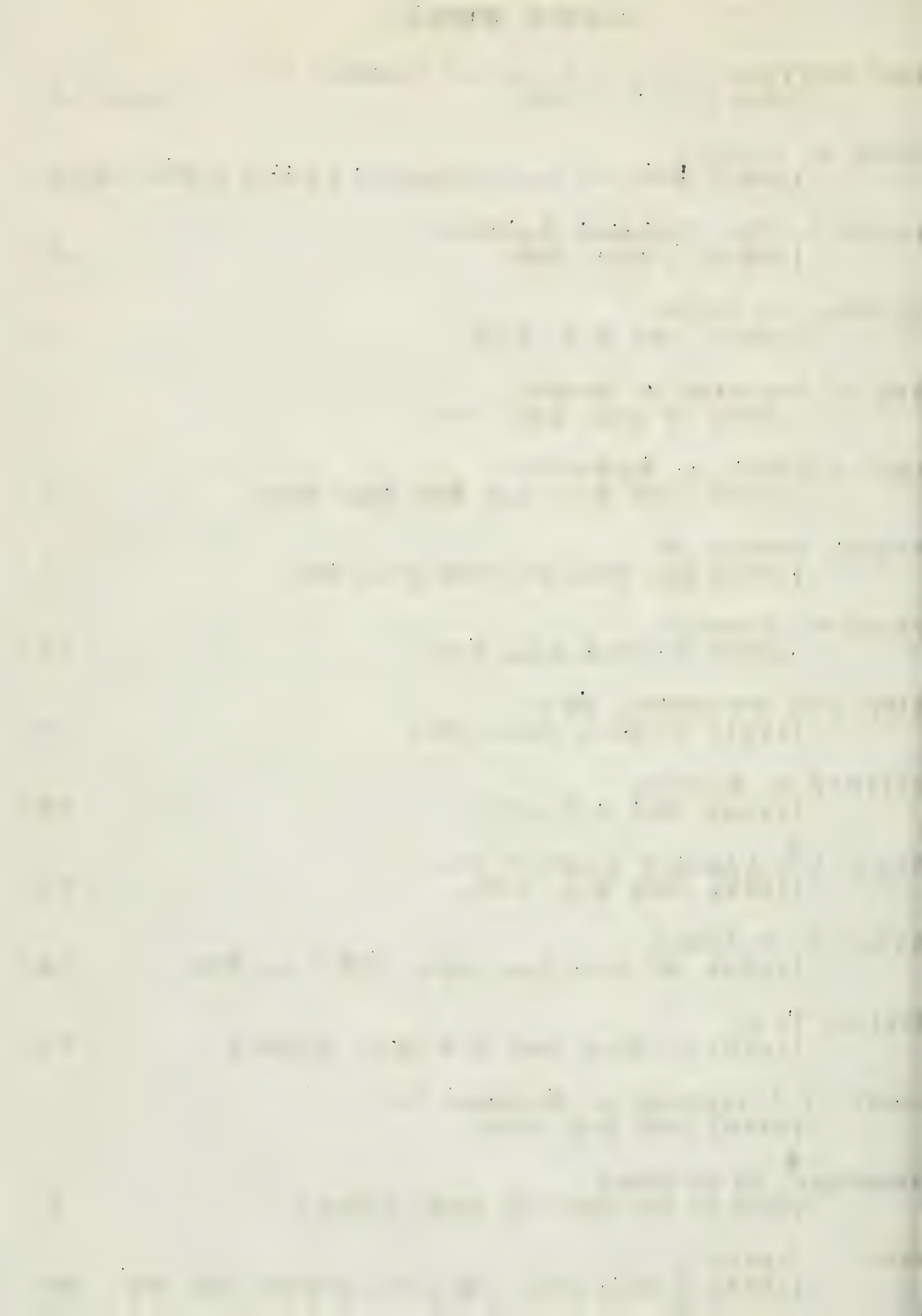
34





<b>Aeame Harvester Co. v. Beckman Lumber Co.</b> (1911) 222 U.S. 300	Page 13
<b>Arnold v. Arnold</b> (1964) Feb. 14 (unpublished) 1 Civil 21272 18,20	
<b>Averill v. The Steamer Hartford</b> (1852) 2 Cal. 308	10
<b>Baldwin, Ex parte</b> (1934) 291 U.S. 610	14
<b>Bank of America v. Mantz</b> (1935) 4 Cal. 2nd 322	15
<b>Bank of Calif. v. McBride</b> (1943) 132 Fed. 2nd 769 (CA, 9th)	14
<b>Boeson, Estate of</b> (1927) 201 Cal. 36, 255 Pac. 800	17
<b>Brazil v. Azevedo</b> (1916) 32 Cal. App. 364	20
<b>Calif. Pea Products, In re</b> (1941) 37 Fed. Supp. 658	13
<b>Callaway v. Benton</b> (1948) 336 U.S. 132	22
<b>Case v. Los Angeles Lumber Co.</b> (1939) 308 U.S. 106	31
<b>Chance v. Kobsted</b> (1934) 66 Cal. App. 434, 226 Pac. 632	8
<b>Clinton, In re</b> (1930) 41 Fed. 2nd 749 (DC, Calif.)	33
<b>County of Allegheny v. Mashuda Co.</b> (1958) 360 U.S. 185	14
<b>Cummings, In re (Mrs.)</b> (1949) 84 Fed. Supp. 65 (DC, Calif.)	8
<b>Cunha v. Cunha</b> (1935) 8 Cal. App. 2nd 413, 48 Pac. 2nd 130	30





Cutting v. Bryan	(1929) 206 Cal. 254, 274 Pac. 326	page 32
Deering -Milliken Co. v. Modern-Aire	(1950) 231 Fed. 2nd 623 (CA, 9th)	30
Engelbrecht v. Wildman	(1959) 263 Fed. 2d 133 (CA, 9th)	11
First Savings Bank v. Butler	(1922) 282 Fed. 866	11
Fraizer, In re	117 Fed. 746 (DC, Mo.)	33
Gibbons v. Goldsmith	(1918) 222 Fed. 826 (CA, 9th)	32
Grolemund v. Cafferata	(1941) 17 Cal. 2nd 679, 111 Pac. 2nd 641	9,15,32
Gross v. Irving Trust Co.	(1933) 289 U.S. 342	10
Hannah v. Swift	(1932) 61 Fed. 2nd 307 (CA, 9th)	16,32
Hardman, In re	(1960) 189 Fed. Supp. 804 (DC, Ind.)	12
Harkin v. Brundage	(1928) 276 U.S. 36	10
Harrold v. Harrold	(1954) 43 Cal. 2nd 77	8
Hornsby v. Hornsby	(1936) 127 Tex. 474, 93 SW 2nd 379	32
Hish v. United States	(1955) 225 Fed. 2nd 3 (CA, 9th)	30
Irving Trust Co. v. Fleming	(1934) 73 Fed. 2nd 423 (CA, 4th)	14
Jacobs, In re	(1934) 7 Fed. Supp. 749 (DC, Ill.)	10



Malb v. Feuerstein (1940) 308 U.S. 433	page 10
Meggett v. Green (1951) 188 Fed. 2nd 817 (CA, 8th)	10
Mord v. Hough (1872) 43 Cal. 581	8
Mach-Tronics v. Zirpoli (1963) 316 Fed. 2nd 820 (CA, 9th)	14
Martolf v. Elliott (1963) 326 Fed. 2nd 204 (CA, 9th)	16
May v. Henderson (1934) 368 U.S. 111	14
McClelland v. Carland (1909) 217 U.S. 268	14
McClenny v. Sup. Ct. (1964) 62 Adv. Cal. 140 at 147	16
Moore, In re (1930) 42 Fed. 2nd 475 (DC, Ga.)	10
Myers v. Motley (1943) 318 U.S. 623	33
Nackard v. Arellanes (1861) 17 Cal. 525	15
Nanton v. Lee (1958) 261 Fed. 2nd 183 (CA, 10th) 10, 12, 16, 20	
Nekin Flow Co., In re (1901) 112 Fed. 306 (CA, 8th)	33
Nenn Genl. Casualty Co., v. Pennsylvania (1935) 294 U.S. 189	22
Notts, In re (1944) 142 Fed. 2nd 883 (DC, Ark.)	12
Smallfield v. Home Ins. Co. (1957) 244 Fed. 2nd 337 (CA, 9th)	30



Smith v. Phlegar	
(1951) 73 Ariz. 11, 236 Pac. 2nd 749	page 24
Straton v. New	
(1931) 283 U.S. 318	13
Sulmeyer v. Pfohlman (1	
(1964) 329 Fed. 2nd 915 (CA, 9th)	16
Taylor v. Sternberg	
(1934) 293 U.S. 470	9, 10, 13
Thygesen v. Neufelder	
(1894) 9 Wash. 455, 37 Pac. 673	33
Union Mutual Life Ins. Co. v. Broderick	
(1925) 196 Cal. 497	32
U.S. Fidelity and Guaranty Co. v. Bray	
(1912) 225 U.S. 205	14
Wai v. Bank of America	
(1961) 56 Cal. 2nd 329	8
Wabash R.R. Co. v. Adelbert College	
(1908) 208 U.S. 38	13
Walker v. Detwiler	
(1940) 110 Fed. 2nd 164 (CA, 6th)	12
Weiby v. Farmers Mutual Ins. Co.	
(1960) 273 Fed. 2nd 327 (CA, 8th)	30
White v. Schloerb	
(1900) 178 542	13

#### STATUTES CITED

Bankruptcy Act, Section 386	26, 31, 33
Civil Code of California, Section 146	15
Section 172a	28, 30, 31, 32
Code of Civil Procedure, California, Sec. 312, 337	28





This appeal is taken from a final judgment made and entered in the United States District Court for the Northern District of California, Southern Division, and is prosecuted in accordance with the provisions of Rule 72 et seq. of the Federal Rules of Civil Procedure. Jurisdiction of this Court is based on Title 11, United States Code, Section 47. Jurisdiction of the District Court is based on Title 11, U.S. Code, Sections 711, and 712.

On June 19, 1962, Appellant J. Howard Arnold filed in the U.S. District Court, San Francisco, an original Petition for an Arrangement with Creditors under Chapter XII, Title 11, U.S. Code. On Sept. 25, 1962, the proceeding was transferred to Chapter XI by amendment.

On October 30, 1962, the Referee, the Honorable Bernard J. Abrott, made and entered an order confirming an Arrangement under Chapter XI. On February 28, 1963, on petition of debtor's wife, Appellee Frances F. Arnold, Referee Abrott made and entered an Order Setting aside Confirmation of Arrangement, under Section 386(2) of the Bankruptcy Act. This order was affirmed on appeal by this Court on January 24, 1964, and rehearing denied on Feb. 27, 1964.

On June 29, 1964, Appellant herein filed an Amended Plan of Arrangement, confirmation of which was denied by the Referee in an order filed Nov. 10, 1964. On Feb. 17, 1965, after hearing, a District Judge, the Honorable Alfonso J. Zirpoli, made and entered a Decision affirming Order of Referee. On March 1, 1965, Appellant moved to alter and amend judgment and findings under Rules 52b and 59e, Federal Rules of Civil Procedure. On March 17, 1965, after hearing and consideration, Judge Zirpoli filed an order denying the motion to alter and amend. Notice of Appeal was filed on April 14, 1965.

[illegible][illegible]

The following information was obtained from the records of the Department of the Interior, Bureau of Land Management, regarding the land owned by the United States in the State of California.

The total area of land owned by the United States in California is approximately 100 million acres. This land is divided into several categories, including National Forests, National Monuments, and other public lands.

The following table shows the distribution of land ownership in California:

Category	Area (Acres)
National Forests	60,000,000
National Monuments	20,000,000
Other Public Lands	20,000,000

This information was obtained from the records of the Department of the Interior, Bureau of Land Management, and is subject to change as new information becomes available.

# STATEMENT OF THE CASE

Basically, this case involves a conflict of jurisdiction in rem between a State divorce court and a Federal court of bankruptcy, with Superior Court usurping power unlawfully in an attempt to transfer title to community assets to Appellee in fraud of creditors, and a U.S. District Court abstaining from assumption and exercise of its paramount and exclusive jurisdiction in rem under the Bankruptcy Act, for reasons of unwarranted comity and perplexity.

The Referee declines to use the term 'jurisdiction in rem', referring to consider the validity of the Superior Court judgment, and concludes that the "award" (i.e., immediate transfer of title) of community real property to Appellee in a divorce action was valid and bars District Court confirmation of an Arrangement involving said property. The award was reversed on appeal to the District Court of Appeal as an improper attempt to transfer title, but the State courts still claim jurisdiction in rem. Pertinent law is clear, but findings, conclusions, and decisions in this and related cases are unclear, garbled, missing, or simply erroneous.

Appellee Frances K. Arnold filed her suit for divorce on November 29, 1961, in Superior Court, Alameda County. She made the customary claim of 'extreme mental cruelty' as ground, and asked that all the principal community assets (including the real property which is the subject of the Arrangement herein) be given to her, with custody of 4 minor children. The Superior Court permitted her to use community funds for counsel fees, but denied that right to Appellant, forcing him to trial without counsel; the denial was affirmed on appeal. Appellee is mentally ill and incompetent to sue; she has been in menopause since Sept. 1960, and since April 1961 has been addicted to excessive amounts of amphetamine pep-pills (the psychotoxic drug Dexedrine). Nevertheless





an interlocutory judgment of divorce was granted on Oct. 22, 1962, 'awarding' her the community real property and other assets. The Superior Court on Feb. 15, 1963, ordered Appellant out of the family home and on March 20, 1963, enforced its order by contempt proceedings.

The District Court of Appeal on Feb. 14, 1964, affirmed the interlocutory decree of divorce and the eviction order, insisted that the Superior Court had jurisdiction in rem, but reversed the "award" of community assets as an immediate transfer of title and limited its becoming effective to a possible future entry of a Final Decree of divorce, as required by California law. (The Final Decree obtained ex parte on April 21, 1964, is being appealed as fraudulent, having been obtained through a false affidavit while the Interlocutory Decree was not finally determined, certiorari ultimately being denied by the U.S. Supreme Court on Oct. 12, 1964.)

On June 19, 1962 (after filing of the divorce action but prior to judgment therein), Appellant J. Howard Arnold filed an original petition for an Arrangement with Creditors under the Bankruptcy Act, listing the family home in his Schedule B-1 as 'community property of petitioner and his wife', stating that no declaration of homestead had been filed, and not claiming it as exempt. The Arrangement plan proposed a second Deed of Trust on this real property in the amount of \$14,750, the affected creditors being Appellant's mother and brother. Pendency of the irrelevant divorce action was not disclosed to the Court.

On Oct. 30, 1962 -- a week after entry of the Interlocutory judgment "awarding" the community real property to Appellee-- the Referee properly confirmed the Arrangement with Creditors. Later, after learning of the prior judgment affecting the same real property, the Referee on Appellee's petition set aside the confirmation on Feb.





8, 1963, under Section 386(2) of the Bankruptcy Act. Unfortunately, the Referee's order (written for his signature by Appellee's counsel) did not make clear that his action was based on the supposed validity of the Superior Court judgment (and resulting loss of jurisdiction in rem by the District Court). The appeal was further complicated by the denial, in Appellee's Reply Brief, that jurisdiction was at issue, and by the absence of adequate explicit findings of fact. This Court refused to rule on the question of jurisdiction in rem and validity of the State court judgment, but affirmed the setting-aside order on other grounds, speculatively but erroneously supplying the missing findings of fact, and thereby rendering the first appeal futile. In July, 1963, Appellant learned from the Referee that the jurisdictional question was foremost, and urged in his briefs that it be decided; but this Court refused.

On June 29, 1964, Appellant submitted an Amended Plan of Arrangement, and requested confirmation of it. On Nov. 10, 1964, the Referee denied confirmation, and on Feb. 17, 1965, District Judge Zirpoli affirmed the order on review. Appellant then moved to alter and amend the findings, conclusions, and judgment, for the sake of clarity as well as to correct error, but the motion was denied on March 17, 1965, and this appeal followed.

The present appeal seeks to reverse the Referee's denial of confirmation by showing that, under established law,

- (1) The Superior Court did not take jurisdiction in rem over the community property on filing of the divorce action Nov. 29, 1961.
- (2) The U.S. District Court did take jurisdiction in rem over the community property on filing of the Arrangement petition on June 19, 1962, which jurisdiction is paramount and exclusive, cannot be divested by the Superior Court, but can displace the Superior Court.





- (3) The Interlocutory Judgment of Oct. 22, 1962, was void as to transfer of title and possession of community property, then in custody of the U.S. District Court, since the Superior Court lacked jurisdiction in rem and could not assume it lawfully by seizure.
- (4) Immediate transfer of title to community property, attempted by the Superior Court, was held improper and reversed on appeal; California law permits only a tentative, hypothetical "award" for the Court's later guidance in rendering a Final Decree of Divorce.
- (5) California law does not permit award of community assets to the wife and community debts to the husband in a divorce judgment, but vests in the wife on Final Decree only the residue (assets less debts); a judgment disposing of assets without consideration of debts is void as in fraud of creditors, and cannot quiet title in the wife against the world, but only against the husband.
- (6) The void property disposal provision of the Interlocutory Judgment was no bar to confirmation of the Arrangement on Oct. 30, 1962; the Referee should not have set it aside, and for the same reason should not have denied confirmation on Nov. 10, 1964.
- (7) No bar to confirmation was established by the previous appeal in this case, the reliance of this Court on Section 172a, Civil Code, having been induced by an erroneous conception of the Referee's findings, which are now clarified in the new order denying confirmation solely because of the Interlocutory Judgment's supposed validity.
- (8) No Final Judgment of divorce can vest the real property in Appellee, as the Superior Court lacks jurisdiction in rem, despite the District Court's abstention; the Final Judgment of April 21, 1964, is wholly void for lack of jurisdiction of the subject-matter, ante-



dating final determination of the Interlocutory Judgment by denial of certiorari by the U.S. Supreme Court on Oct. 12, 1964.

## SPECIFICATION OF ERRORS

- (1) The Referee erred in his Finding of Fact (IV) (Clerk's Transcript p. 32, line 13) that the immediate award of the real property to the Appellee was affirmed on appeal; the award was in fact modified so as to reverse it as improper, and postpone it to Final Decree.
- (2) The Referee erred in his Conclusion of Law (I) (Clerk's Transcript p. 33, line 16) that the Interlocutory Judgment, in its property award provisions, "was valid and bars the involvement of said property in the arrangement"; the award was void ab initio for lack of jurisdiction of the subject-matter, void when recorded for lack of jurisdiction in rem, and reversed by the District Court *of Appeal* Feb. 14, 1964.
- (3) The Referee erred in his Conclusion of Law (II) that Appellant has "no right, title or interest in and to said real property"; as Debtor in possession acting as trustee for the U.S. District Court, which holds the property in custodia legis, he has held the legal title to said property since filing his original petition on June 19, 1962.
- (4) The Referee erred in his Conclusion of Law (III) (Clerk's Trans. p. 33, line 26) that "... confirmation ... is barred by the decision of the Court of Appeals" in the prior appeal involving the setting aside of a confirmation; the invoking of Section 172a, Civil Code, in that decision arose from an incorrect concept of the Referee's findings, which have now been corrected and amplified to make clear that only the validity of the Superior Court judgment is in question, and no fraud is charged. or debts ruled not allowable.
- (5) The District Judge erred in refusing to make an independent deter-



1. The first part of the document is a list of references. The references are as follows:

1. J. H. Van Veen, "Acoustic signal processing for underwater sound source localization," *IEEE J. Oceanic Technol.*, vol. 13, no. 3, pp. 407-420, 1996.
2. J. H. Van Veen, "Acoustic signal processing for underwater sound source localization," *IEEE J. Oceanic Technol.*, vol. 13, no. 3, pp. 407-420, 1996.
3. J. H. Van Veen, "Acoustic signal processing for underwater sound source localization," *IEEE J. Oceanic Technol.*, vol. 13, no. 3, pp. 407-420, 1996.
4. J. H. Van Veen, "Acoustic signal processing for underwater sound source localization," *IEEE J. Oceanic Technol.*, vol. 13, no. 3, pp. 407-420, 1996.
5. J. H. Van Veen, "Acoustic signal processing for underwater sound source localization," *IEEE J. Oceanic Technol.*, vol. 13, no. 3, pp. 407-420, 1996.
6. J. H. Van Veen, "Acoustic signal processing for underwater sound source localization," *IEEE J. Oceanic Technol.*, vol. 13, no. 3, pp. 407-420, 1996.
7. J. H. Van Veen, "Acoustic signal processing for underwater sound source localization," *IEEE J. Oceanic Technol.*, vol. 13, no. 3, pp. 407-420, 1996.
8. J. H. Van Veen, "Acoustic signal processing for underwater sound source localization," *IEEE J. Oceanic Technol.*, vol. 13, no. 3, pp. 407-420, 1996.
9. J. H. Van Veen, "Acoustic signal processing for underwater sound source localization," *IEEE J. Oceanic Technol.*, vol. 13, no. 3, pp. 407-420, 1996.
10. J. H. Van Veen, "Acoustic signal processing for underwater sound source localization," *IEEE J. Oceanic Technol.*, vol. 13, no. 3, pp. 407-420, 1996.

...  
...  
...

1. The first group of people who are interested in the results of the study are the researchers themselves. They want to know how well the study was conducted and whether the results are reliable and valid. They also want to know how the study was funded and whether there were any conflicts of interest.

6 7 8 9 10 11 12 13 14 15 16 17 18 19 20 21 22 23 24 25 26 27 28 29 30 31 32 33 34 35 36 37 38 39 40 41 42 43 44 45 46 47 48 49 50 51 52 53 54 55 56 57 58 59 60 61 62 63 64 65 66 67 68 69 70 71 72 73 74 75 76 77 78 79 80 81 82 83 84 85 86 87 88 89 90 91 92 93 94 95 96 97 98 99 100 101 102 103 104 105 106 107 108 109 110 111 112 113 114 115 116 117 118 119 120 121 122 123 124 125 126 127 128 129 130 131 132 133 134 135 136 137 138 139 140 141 142 143 144 145 146 147 148 149 150 151 152 153 154 155 156 157 158 159 160 161 162 163 164 165 166 167 168 169 170 171 172 173 174 175 176 177 178 179 180 181 182 183 184 185 186 187 188 189 190 191 192 193 194 195 196 197 198 199 200 201 202 203 204 205 206 207 208 209 210 211 212 213 214 215 216 217 218 219 220 221 222 223 224 225 226 227 228 229 230 231 232 233 234 235 236 237 238 239 240 241 242 243 244 245 246 247 248 249 250 251 252 253 254 255 256 257 258 259 260 261 262 263 264 265 266 267 268 269 270 271 272 273 274 275 276 277 278 279 280 281 282 283 284 285 286 287 288 289 290 291 292 293 294 295 296 297 298 299 300 301 302 303 304 305 306 307 308 309 310 311 312 313 314 315 316 317 318 319 320 321 322 323 324 325 326 327 328 329 330 331 332 333 334 335 336 337 338 339 340 341 342 343 344 345 346 347 348 349 350 351 352 353 354 355 356 357 358 359 360 361 362 363 364 365 366 367 368 369 370 371 372 373 374 375 376 377 378 379 380 381 382 383 384 385 386 387 388 389 390 391 392 393 394 395 396 397 398 399 400 401 402 403 404 405 406 407 408 409 410 411 412 413 414 415 416 417 418 419 420 421 422 423 424 425 426 427 428 429 430 431 432 433 434 435 436 437 438 439 440 441 442 443 444 445 446 447 448 449 450 451 452 453 454 455 456 457 458 459 460 461 462 463 464 465 466 467 468 469 470 471 472 473 474 475 476 477 478 479 480 481 482 483 484 485 486 487 488 489 490 491 492 493 494 495 496 497 498 499 500 501 502 503 504 505 506 507 508 509 510 511 512 513 514 515 516 517 518 519 520 521 522 523 524 525 526 527 528 529 530 531 532 533 534 535 536 537 538 539 540 541 542 543 544 545 546 547 548 549 550 551 552 553 554 555 556 557 558 559 560 561 562 563 564 565 566 567 568 569 570 571 572 573 574 575 576 577 578 579 580 581 582 583 584 585 586 587 588 589 590 591 592 593 594 595 596 597 598 599 600 601 602 603 604 605 606 607 608 609 610 611 612 613 614 615 616 617 618 619 620 621 622 623 624 625 626 627 628 629 630 631 632 633 634 635 636 637 638 639 640 641 642 643 644 645 646 647 648 649 650 651 652 653 654 655 656 657 658 659 660 661 662 663 664 665 666 667 668 669 670 671 672 673 674 675 676 677 678 679 680 681 682 683 684 685 686 687 688 689 690 691 692 693 694 695 696 697 698 699 700 701 702 703 704 705 706 707 708 709 710 711 712 713 714 715 716 717 718 719 720 721 722 723 724 725 726 727 728 729 730 731 732 733 734 735 736 737 738 739 740 741 742 743 744 745 746 747 748 749 750 751 752 753 754 755 756 757 758 759 760 761 762 763 764 765 766 767 768 769 770 771 772 773 774 775 776 777 778 779 780 781 782 783 784 785 786 787 788 789 790 791 792 793 794 795 796 797 798 799 800 801 802 803 804 805 806 807 808 809 810 811 812 813 814 815 816 817 818 819 820 821 822 823 824 825 826 827 828 829 830 831 832 833 834 835 836 837 838 839 840 841 842 843 844 845 846 847 848 849 850 851 852 853 854 855 856 857 858 859 860 861 862 863 864 865 866 867 868 869 870 871 872 873 874 875 876 877 878 879 880 881 882 883 884 885 886 887 888 889 890 891 892 893 894 895 896 897 898 899 900 901 902 903 904 905 906 907 908 909 910 911 912 913 914 915 916 917 918 919 920 921 922 923 924 925 926 927 928 929 930 931 932 933 934 935 936 937 938 939 940 941 942 943 944 945 946 947 948 949 950 951 952 953 954 955 956 957 958 959 960 961 962 963 964 965 966 967 968 969 970 971 972 973 974 975 976 977 978 979 980 981 982 983 984 985 986 987 988 989 990 991 992 993 994 995 996 997 998 999 1000 1001 1002 1003 1004 1005 1006 1007 1008 1009 1010 1011 1012 1013 1014 1015 1016 1017 1018 1019 1020 1021 1022 1023 1024 1025 1026 1027 1028 1029 1030 1031 1032 1033 1034 1035 1036 1037 1038 1039 1040 1041 1042 1

mination of the questions of fact and law and merely adopting the findings and conclusions of the Referee, and in refusing to clarify the vague and uncertain language of the Referee's order in holding that the prior decision of this Court required conformity to Section 172a, Civil Code.

### SUMMARY OF ARGUMENT

The Referee denied confirmation of the proposed Arrangement because he presumed an Interlocutory Judgment of divorce "awarding" the real property involved to Appellee effected a valid immediate transfer of title to her. The Interlocutory Judgment was not valid, but void for lack of jurisdiction *in rem*, which the Superior Court has never held, but which the U.S. District took on filing of Appellant's original petition under the Bankruptcy Act. The attempted transfer of title was improper, and was reversed on appeal. California law does not permit award of community assets to a wife without allowance for community debts; only the residue (assets less debts) vests in the wife on entry of a valid Final Judgment of divorce, and then only if the Superior Court can take the necessary jurisdiction in rem.

This Court's decision in a prior appeal of the setting-aside of a previous plan of Arrangement after confirmation held that a wife's consent was necessary to confirmation, under Section 172a, Civil Code, because the effect of it is to encumber community real property on a voluntary petition by the husband. That decision was based on an erroneous concept of the Referee's findings and avoided a determination of the basic question of conflict of jurisdiction in rem between State and Federal courts. The prior decision is dictum, does not determine the law of the case; it is wholly irrelevant to the present appeal, and does not bar confirmation; State law does not supersede Federal law.

at the time of the trial, but the fact that the defendant was not present at the trial is not a bar to the admission of the evidence. The fact that the defendant was not present at the trial is not a bar to the admission of the evidence.

The following information was obtained from the records of the Department of the Interior, Bureau of Land Management, regarding the land owned by the United States in the State of California.

The total area of land owned by the United States in California is approximately 100 million acres. This land is divided into several categories, including National Forests, National Monuments, and other public lands.

The following table shows the distribution of land ownership in California:

Category	Area (Acres)
National Forests	60,000,000
National Monuments	20,000,000
Other Public Lands	20,000,000

This information was obtained from the records of the Department of the Interior, Bureau of Land Management, dated [Date].

[illegible]

part A: The Interlocutory Judgment of Divorce does not bar confirmation.

# I

Superior Court does not take jurisdiction in rem over community property on filing of a divorce action.

In some types of suit, where control of the res is essential to the basic decision (e.g., mortgage foreclosures), filing of the suit is sufficient to accomplish a legal seizure and give the court jurisdiction in rem. In a divorce suit, however, disposal of the community property is unessential to deciding the main issue of divorce, and jurisdiction in rem is not taken until entry of judgment, the property remaining under the management and control of the husband.

In re Cummings (1949) 84 Fed. Supp. 65 (DC, Cal.)

Chance v. Kobsted (1934) 66 Cal. App. 434

Lord v. Hough (1872) 43 Cal. 581

These three cases are customarily quoted in decisions of the Supreme Court of California as decisive on this point of jurisdiction in rem.

Harrold v. Harrold (1954) 43 Cal. 2nd 77

Vai v. Bank of America (1961) 56 Cal. 2nd 329

From the filing of the divorce action on Nov. 29, 1961, to rendition of judgment on Oct. 22, the Superior Court took no jurisdiction in rem by seizure of the community property, and made no attempt to do so. When the attempt was made by recording of judgment on Oct. 23, 1962, it was too late: the property had been seized on July 19, 1962, by the U.S. District Court, exercising its paramount and indivestible right under the Bankruptcy Act to take jurisdiction in rem for the benefit of creditors, on Appellant's petition.





U.S. District Court takes jurisdiction in rem by legal seizure of a debtor's property, including community assets, on filing of his original petition under the Bankruptcy Act. That jurisdiction is exclusive.

is well settled that the filing of a debtor's petition initiating proceedings under the Bankruptcy Act constitutes legal seizure of the debtor's property. The property seized includes community property if the debtor is a husband, but not if the debtor is a wife (who holds no ownership interest, reachable by creditors through judicial process, but only a protected expectancy, an heirship).

Grolemund v. Cafferata (1941) 17 Cal. 2nd 679

Taylor v. Sternberg (1934) 293 U.S. 470

"The filing of the petition is an assertion of jurisdiction with a view to the determination of the status of the (debtor) and a settlement and distribution of his estate. This jurisdiction is exclusive within the field defined by the law, and is so far in rem that the estate is regarded as in custodia legis from the filing of the petition. . . It follows that liens cannot thereafter be obtained nor proceedings be had in other courts to reach the property, the District Court having acquired the exclusive right to administer all property in the (debtor's) possession. . . ."

Straton v. New (1931) 283 U.S. 318

Jurisdiction in rem is inherently exclusive; it cannot be concurrent, to be held and exercised jointly by State and Federal courts contemplating different disposals of the res. Obviously, when a Superior Court seeks to give community assets to a divorcing wife in fraud of creditors, and a U.S. District Court acts for the creditors, a conflict arises.



the first of these is the fact that the

the second is the fact that the

the third is the fact that the

the fourth is the fact that the

the fifth is the fact that the

the sixth is the fact that the

the seventh is the fact that the

the eighth is the fact that the

the ninth is the fact that the

the tenth is the fact that the

the eleventh is the fact that the

the twelfth is the fact that the

the thirteenth is the fact that the

the fourteenth is the fact that the

the fifteenth is the fact that the

the sixteenth is the fact that the

the seventeenth is the fact that the

the eighteenth is the fact that the

the nineteenth is the fact that the

the twentieth is the fact that the

the twenty-first is the fact that the

the twenty-second is the fact that the

the twenty-third is the fact that the

the twenty-fourth is the fact that the

the twenty-fifth is the fact that the

Jurisdiction in rem can be held by only one court at a time; in case of conflict, the Bankruptcy Act gives the U.S. District Court paramount and exclusive jurisdiction.

In the Superior Court case of Arnold v. Arnold, that Court has never taken jurisdiction in rem over the community property. Had it made a legal seizure of the property early in the divorce action, it would have been displaced by the U.S. District Court when the original petition for an Arrangement was filed, as its bankruptcy jurisdiction is paramount.

In re Jacobs (1934) 7 Fed. Supp. 749 (DC, Ill.)

Taylor v. Sternberg (1934) 293 U.S. 470

"The fact that the jurisdiction of the (Federal) court is paramount effectually distinguished that class of cases which hold that as between courts of concurrent jurisdiction property already in the hands of a receiver of one of them cannot rightfully be taken from him without that court's consent by a receiver subsequently appointed by the other court. . . the jurisdiction of the (federal) court is paramount and not concurrent. . . the power of the state court . . necessarily came to an end with the supervening bankruptcy."

Gross v. Irving Trust Co. (1933) 289 U.S. 342

Jurisdiction in rem is acquired by the court making the first seizure, not the court in which an action is first filed.

Averill v. The Steamer Hartford (1852) 2 Cal. 308

Harkin v. Brundage (1928) 276 U.S. 36

Leggett v. Green (1951) 188 Fed. 2nd 817 (CA, 8th)

Panton v. Lee (1958) 261 Fed. 2nd 183 (CA, 10th)

In general, however, any other court first seizing the property must later relinquish it to the bankruptcy court, without regard to comity.

... ..

... ..

... ..

*Journal of Interpersonal Violence* 26(8)

"... its being prior in time cuts no figure. The priority of right in the bankruptcy court... must prevail... without regard to the rules of comity, for as respects this matter the courts are not of concurrent jurisdiction."

In re Moore (1930) 42 Fed. 2nd 475 (DC, Ga.)

"There is no question of that comity arising between courts of concurrent jurisdiction in this case... Under the Constitution the jurisdiction of a court of bankruptcy in administering the estates of (debtors) under the provisions of the Bankruptcy Act is complete and exclusive, and it is not only the right, but the duty, of such courts to draw unto themselves all the property of the... estate and the determination of all claims and demands existing..."

First Savings Bank v. Butler (1932) 282 Fed. 866

the only recognized exception to the paramount jurisdiction in rem of the bankruptcy court occurs when the suit in the other court has the purpose of enforcing a pre-existing lien, as in a foreclosure.

"A state court has exclusive jurisdiction of the res only to the extent the liens thereon are valid as against the trustee in bankruptcy... state court action, to the extent it may have attempted to deal in rem with the property, abated upon the filing of the petition."

Engelbrecht v. Wildman (1959) 263 Fed. 2nd 133 (CA, 9th)

"The test that determines jurisdiction is... whether there exists a debt, no matter how arising, which may be enforced against the (debtor) or the (debtor's) estate... The debtor having by his petition placed his property within the jurisdiction of the (Federal) Court, ... all subsequent proceedings in the State Court, including the writ by which he was dispossessed, are a nullity..."



The first part of the paper is devoted to a general discussion of the problem of the existence of a solution of the system of equations (1) for arbitrary values of the parameters  $\alpha$  and  $\beta$ . It is shown that the system (1) has a solution for arbitrary values of the parameters  $\alpha$  and  $\beta$  if and only if the condition  $\alpha + \beta = 1$  is satisfied.

In the second part of the paper the problem of the existence of a solution of the system (1) for arbitrary values of the parameters  $\alpha$  and  $\beta$  is solved. It is shown that the system (1) has a solution for arbitrary values of the parameters  $\alpha$  and  $\beta$  if and only if the condition  $\alpha + \beta = 1$  is satisfied.

The third part of the paper is devoted to a general discussion of the problem of the existence of a solution of the system of equations (1) for arbitrary values of the parameters  $\alpha$  and  $\beta$ . It is shown that the system (1) has a solution for arbitrary values of the parameters  $\alpha$  and  $\beta$  if and only if the condition  $\alpha + \beta = 1$  is satisfied.

In the fourth part of the paper the problem of the existence of a solution of the system (1) for arbitrary values of the parameters  $\alpha$  and  $\beta$  is solved. It is shown that the system (1) has a solution for arbitrary values of the parameters  $\alpha$  and  $\beta$  if and only if the condition  $\alpha + \beta = 1$  is satisfied.

The fifth part of the paper is devoted to a general discussion of the problem of the existence of a solution of the system of equations (1) for arbitrary values of the parameters  $\alpha$  and  $\beta$ . It is shown that the system (1) has a solution for arbitrary values of the parameters  $\alpha$  and  $\beta$  if and only if the condition  $\alpha + \beta = 1$  is satisfied.

In the sixth part of the paper the problem of the existence of a solution of the system (1) for arbitrary values of the parameters  $\alpha$  and  $\beta$  is solved. It is shown that the system (1) has a solution for arbitrary values of the parameters  $\alpha$  and  $\beta$  if and only if the condition  $\alpha + \beta = 1$  is satisfied.

The seventh part of the paper is devoted to a general discussion of the problem of the existence of a solution of the system of equations (1) for arbitrary values of the parameters  $\alpha$  and  $\beta$ . It is shown that the system (1) has a solution for arbitrary values of the parameters  $\alpha$  and  $\beta$  if and only if the condition  $\alpha + \beta = 1$  is satisfied.

In the eighth part of the paper the problem of the existence of a solution of the system (1) for arbitrary values of the parameters  $\alpha$  and  $\beta$  is solved. It is shown that the system (1) has a solution for arbitrary values of the parameters  $\alpha$  and  $\beta$  if and only if the condition  $\alpha + \beta = 1$  is satisfied.

The ninth part of the paper is devoted to a general discussion of the problem of the existence of a solution of the system of equations (1) for arbitrary values of the parameters  $\alpha$  and  $\beta$ . It is shown that the system (1) has a solution for arbitrary values of the parameters  $\alpha$  and  $\beta$  if and only if the condition  $\alpha + \beta = 1$  is satisfied.

In the tenth part of the paper the problem of the existence of a solution of the system (1) for arbitrary values of the parameters  $\alpha$  and  $\beta$  is solved. It is shown that the system (1) has a solution for arbitrary values of the parameters  $\alpha$  and  $\beta$  if and only if the condition  $\alpha + \beta = 1$  is satisfied.

Walker v. Detwiler (1940) 110 Fed. 2nd 164 (CA, 6th)

In re Hardman (1960) 189 Fed. Supp. 804 (DC, Ind.)

Divorce cases do not fall within this category of exceptions to the rule of paramount jurisdiction in rem of the bankruptcy court, as the wife has no prior lien on the property.

Panton v. Lee, *supra*; quoted *infra*, p. 24

Community property is open to seizure by the bankruptcy court at any time during the pendency of a divorce action, prior to judgment in the divorce court.

#### IV

After Federal bankruptcy court seizure, judgments taken against property in another court are null and void for lack of jurisdiction in rem, and no new judgment liens may attach to the property.

After the filing of an original petition under the Bankruptcy Act, the U.S. District Court holds paramount and exclusive jurisdiction over the property of the debtor, until the proceeding is finally terminated. No other court, State or Federal, can legally interfere with District Court possession and control of the property during this period of time.

"Upon filing a petition under Chapter XII, all of the property of the Debtor is brought within the jurisdiction of the . . . Court, which jurisdiction is paramount and exclusive, and thereafter no action taken in any other court can affect the proceedings in the (Federal) Court. Since the judgment of the State court . . . is the sole foundation for claimant(s) . . . claim, the judgment being void, the claim is void and, likewise, the whole decree of the State court."

In re Potts (1944) 142 Fed. 2nd 883 (DC, Ark.)

"Upon such filing, the jurisdiction of the Court becomes paramount



1871

1872

1873

1874

1875

1876

1877

1878

1879

1880

1881

1882

and exclusive; and thereafter that Court's possession and control cannot be affected by proceedings in other courts, whether State or Federal."

Taylor v. Sternberg (1934) 293 U.S. 470

White v. Schloerb (1900) 178 U.S. 542

Any act by a State court interfering with Federal court custody is void, whether contested or not, without formal sanction by the Federal court and assent by the debtor.

In re Calif. Pea Products (1941) 37 Fed. Supp. 658

Kalb v. Feuerstein (1940) 308 U.S. 433

"The defendant below set up a proceeding in a Federal court as a protection against further prosecution in the state court. . . Thereby the defendant claimed the benefit of a Federal right. . . Should the state court have declined to exercise its jurisdiction when the pending proceeding was. . . set up in denial of the right to entertain further proceedings in the state tribunal? . . . It is . . . certain that an attachment of the bankrupt's property after the filing of the petition and before adjudication cannot operate to remove the (debtor's) estate from the jurisdiction of the bankruptcy court. . . "

Acme Harvester v. Beekman Co. (1911) 222 U.S. 300

The property disposal provisions of the Interlocutory Judgment of Oct. 2, 1962, and of the Final Judgment of April 21, 1964 (which is also void for fraud) in the Superior Court are thus null and void for lack of jurisdiction in rem, which has never been taken in that case by the Superior Court and was no longer available to it after District Court seizure of appellant's property on June 19, 1962, when his original petition was filed.

Straton v. New (1931) 283 U.S. 318

Wabash R.R. v. Adelbert College (1908) 208 U.S. 38

# THE JOURNAL OF THE AMERICAN MEDICAL ASSOCIATION

PUBLISHED WEEKLY  
CHICAGO, ILL., MAY 1, 1919

It is the policy of this journal to publish only such material as is of general interest to the medical profession and the public. It is not a place for the publication of local or personal matters.

Original articles and reports of original researches are invited.

Contributors are asked to send their manuscripts to the Editor, J. H. T. Moore, M.D., 535 North Dearborn Street, Chicago, Ill.

Manuscripts should be sent in duplicate, and should be accompanied by a letter from the author.

The Journal is published weekly, except on Sundays and public holidays. It is published for the American Medical Association, which is a non-profit-making organization. The Journal is owned by the American Medical Association, and is published by the American Medical Association, 535 North Dearborn Street, Chicago, Ill.

The Journal is published for the American Medical Association, which is a non-profit-making organization. The Journal is owned by the American Medical Association, and is published by the American Medical Association, 535 North Dearborn Street, Chicago, Ill.

Contributors are asked to send their manuscripts to the Editor, J. H. T. Moore, M.D., 535 North Dearborn Street, Chicago, Ill.

Manuscripts should be sent in duplicate, and should be accompanied by a letter from the author.

The Journal is published weekly, except on Sundays and public holidays.

It is the policy of this journal to publish only such material as is of general interest to the medical profession and the public. It is not a place for the publication of local or personal matters. Original articles and reports of original researches are invited. Contributors are asked to send their manuscripts to the Editor, J. H. T. Moore, M.D., 535 North Dearborn Street, Chicago, Ill. Manuscripts should be sent in duplicate, and should be accompanied by a letter from the author.

Contributors are asked to send their manuscripts to the Editor, J. H. T. Moore, M.D., 535 North Dearborn Street, Chicago, Ill.

Manuscripts should be sent in duplicate, and should be accompanied by a letter from the author.

Jurisdiction in rem, once taken, may not be relinquished by a court of bankruptcy over the protest of the debtor; the court may not abstain from assumption and exercise of its paramount and exclusive jurisdiction.

The U.S. District Court may not lawfully turn over its jurisdiction in rem to a State divorce court, but must exercise and defend it.

"... the jurisdiction of the bankruptcy courts in all 'proceedings in bankruptcy' is intended to be exclusive of all other courts. . . . Creditors are entitled to have this authority exercised. . the court. . was not at liberty to surrender its exclusive control. . ."

U.S. Fidelity Guar. v. Bray (1912) 225 U.S. 305

The District Court may not abstain from exercise of its jurisdiction for procedural reasons, except in very unusual circumstances which are not present in the case at bar.

Mach-Tronics v. Zirpoli (1963) 316 Fed. 2nd 820 (CA, 9th)

County of Allegheny v. Mashuda Co. (1958) 360 U.S. 185

The paramount and exclusive jurisdiction in rem of the Federal court cannot be lost through illegal invasion of it by a State court,

McClelland v. Carland (1909) 217 U.S. 268

Ex parte Baldwin (1934) 291 U.S. 610

Irving Trust Co. v. Fleming (1934) 73 Fed. 2nd 423 (CA, 4th)

or through adverse seizure of the res by a State court,

Bank of Calif. v. McBride (1943) 132 Fed. 2nd 769 (CA, 9th)

May v. Henderson (1934) 368 U.S. 111 (reverses CA, 9th)

but remains with the court of bankruptcy, despite that court's efforts to divest itself of its power and the State court's determined efforts to usurp the untended jurisdiction with complete disregard of justice and law.





A divorce judgment purporting to award community assets to the wife, in fraud of creditors, and community debts to the husband, is contrary to California law, and void.

"Community property", as the term is used in the divorce laws,

Section 146, Civil Code of California

does not refer to assets, but to the residue left after allowance is made for the unsecured and secured debts of the husband (which, in California, are community debts for which community property is liable).

Packard v. Arellanes (1961) 17 Cal. 525

Bank of America v. Mantz (1935) 4 Cal. 2nd 322

Grolemund v. Cafferata (1941) 17 Cal. 2nd 679

Earlier, this Court decided against another California wife who sought to take community assets without paying creditors' claims against the marital community, and in that decision this Court followed established law:

"(Her) contention seems to be that as a member of the marital community she is entitled to the possession of the entire community property and the community debts must go unpaid, save and except such indebtedness as is secured by mortgage or other encumbrance executed by the husband and wife. . . It would seem to be a sufficient answer to (her) contention to call attention to the fact that the Supreme Court of California, as early as 1861, . . . . held that the term 'community property' as used in the statutes of California as between husband and wife and the creditors meant a residuum of the property . . after the payment of the community debts. . the courts of California have decided that the community property . . . is subject to community debts. . It follows that the



THE UNIVERSITY OF CHICAGO

THE DIVISION OF THE PHYSICAL SCIENCES

DEPARTMENT OF PHYSICS

PHYSICS 300

LECTURE 1

THEORY OF QUANTUM MECHANICS

LECTURE 2

THEORY OF QUANTUM MECHANICS

LECTURE 3

LECTURE 4

LECTURE 5

LECTURE 6

LECTURE 7

LECTURE 8

LECTURE 9

LECTURE 10

LECTURE 11

LECTURE 12

LECTURE 13

LECTURE 14

LECTURE 15

LECTURE 16

LECTURE 17

LECTURE 18

LECTURE 19

trustee in bankruptcy . . . is entitled to the possession of community property for the benefit of creditors. . . ."

Hannah v. Swift (1932) 61 Fed.2nd 307 (CA, 9th)

The decision has been twice reaffirmed during the past two years.

Martolf v. Elliott (1963) 326 Fed.2nd 204 (CA, 9th)

Sulmeyer v. Pfohlman (1964) 329 Fed.2nd 915 (CA, 9th)

There is no adequate reason for not following the Hannah decision in the case at bar, in which Federal courts have permitted illegal seizure and disposal of Appellant's debtor's estate by an aggressive and ruthless divorce court acting in open defiance of State and Federal law.

A divorce action between two spouses is inherently incapable of nullifying the rights of creditors unjoined as defendants, but can only determine the rights of the parties by a judgment in personam. The divorce court cannot legally award community assets to a wife free and clear of creditors' claims.

Panton v. Lee, supra; quoted infra, p. 24

"This divorce action is not an *in rem* action to quiet title against the world; it is a disposition of property as between the spouses incident to the dissolution of the marital relation."

McClenny v. Sup. Ct. (1964) 62 Adv. Cal. 140 at 147

In the divorce action between the parties to the case at bar, the trial judge not only failed to consider the debts (which were prominently at issue in the trial), but refused to recognize the paramount jurisdiction in rem of the District Court over the assets which he sought to transfer immediately to Appellee by Interlocutory Judgment. Without all creditors joined as defendants, or any provision for meeting their claims against the marital community, the Superior Court had no power to dispose of community assets free and clear of creditors' claims.

Vol. 26, No. 19, Published May 1, 1919

Subscription price, Five Dollars per Annum in Advance

Single Copies, Fifteen Cents

Entered as Second-Class Matter, May 2, 1912, Post Office at Chicago, Ill., under No. 323,661

Acceptance for mailing at special rate of postage provided for in Act of October 3, 1917, authorized on March 1, 1919. Postage paid at Chicago, Ill., and at additional mailing offices. Postmaster: Send address changes in this journal to THE JOURNAL OF THE AMERICAN MEDICAL ASSOCIATION, 535 North Dearborn Street, Chicago 10, Ill.

Copyright, 1919, by American Medical Association

Published by the American Medical Association, 535 North Dearborn Street, Chicago 10, Ill.

Editor: J. C. Thompson, M.D., 535 North Dearborn Street, Chicago 10, Ill.

Business Manager: J. C. Thompson, M.D., 535 North Dearborn Street, Chicago 10, Ill.

Subscription Department: 535 North Dearborn Street, Chicago 10, Ill.

## CONTENTS

Original Articles: The Medical Profession and the Public, J. C. Thompson, M.D., 535 North Dearborn Street, Chicago 10, Ill.

Editorial: The Medical Profession and the Public, J. C. Thompson, M.D., 535 North Dearborn Street, Chicago 10, Ill.

Department: The Medical Profession and the Public, J. C. Thompson, M.D., 535 North Dearborn Street, Chicago 10, Ill.

Book Reviews: The Medical Profession and the Public, J. C. Thompson, M.D., 535 North Dearborn Street, Chicago 10, Ill.

Correspondence: The Medical Profession and the Public, J. C. Thompson, M.D., 535 North Dearborn Street, Chicago 10, Ill.

Obituary: The Medical Profession and the Public, J. C. Thompson, M.D., 535 North Dearborn Street, Chicago 10, Ill.

Announcements: The Medical Profession and the Public, J. C. Thompson, M.D., 535 North Dearborn Street, Chicago 10, Ill.

Advertisements: The Medical Profession and the Public, J. C. Thompson, M.D., 535 North Dearborn Street, Chicago 10, Ill.

Index: The Medical Profession and the Public, J. C. Thompson, M.D., 535 North Dearborn Street, Chicago 10, Ill.

Table of Contents: The Medical Profession and the Public, J. C. Thompson, M.D., 535 North Dearborn Street, Chicago 10, Ill.

Subscription Information: The Medical Profession and the Public, J. C. Thompson, M.D., 535 North Dearborn Street, Chicago 10, Ill.

Advertising Information: The Medical Profession and the Public, J. C. Thompson, M.D., 535 North Dearborn Street, Chicago 10, Ill.

property disposal provisions in an Interlocutory Judgment of divorce are preliminary and tentative, taking effect only if and when the marriage is dissolved by final Judgment of Divorce, and subject to revision.

An Interlocutory Judgment is merely a tentative finding at the time of trial to serve as a guide later in making the property disposal in the final Judgment of Divorce. It is a judgment in personam, requiring no jurisdiction in rem over the community assets for its rendition.

"In sum, the interlocutory decree is merely a determination that after the lapse of a year the parties would, if no impediments have arisen, be entitled to a decree dissolving the marital relation and disposing of the community property in the manner described in the interlocutory decree. Its provisions are not operative until the entry of the final decree."

Estate of Boeson (1927) 201 Cal. 36

In the Arnold v. Arnold divorce action, (1) debts were not considered as creditors joined as defendants, hence the determination of Appellee's rights to community assets by the trial judge was void; (2) already an insuperable impediment to the property disposal had arisen in the form of Appellant's invoking of exclusive District Court jurisdiction in rem by his petition for an Arrangement with Creditors; and, finally, (3) the trial judge's attempt at immediate transfer of title to community assets from husband to wife had no sanction in law, and was reversed on appeal as "improper"-- lacking jurisdiction of the subject-matter. Contrary to the Referee's finding of fact, the Interlocutory Judgment was not affirmed as to property, on appeal, but effectively reversed by being



THE UNIVERSITY OF CHICAGO PRESS

THE UNIVERSITY OF CHICAGO PRESS

THE UNIVERSITY OF CHICAGO PRESS

THE UNIVERSITY OF CHICAGO PRESS

THE UNIVERSITY OF CHICAGO PRESS

THE UNIVERSITY OF CHICAGO PRESS

THE UNIVERSITY OF CHICAGO PRESS

THE UNIVERSITY OF CHICAGO PRESS

THE UNIVERSITY OF CHICAGO PRESS

THE UNIVERSITY OF CHICAGO PRESS

THE UNIVERSITY OF CHICAGO PRESS

THE UNIVERSITY OF CHICAGO PRESS

THE UNIVERSITY OF CHICAGO PRESS

THE UNIVERSITY OF CHICAGO PRESS

THE UNIVERSITY OF CHICAGO PRESS

THE UNIVERSITY OF CHICAGO PRESS

THE UNIVERSITY OF CHICAGO PRESS

THE UNIVERSITY OF CHICAGO PRESS

THE UNIVERSITY OF CHICAGO PRESS

THE UNIVERSITY OF CHICAGO PRESS

THE UNIVERSITY OF CHICAGO PRESS

THE UNIVERSITY OF CHICAGO PRESS

"The interlocutory decree, however, makes a present disposition of the community property. It is now settled that such an award is improper and, where made, should be modified by the appellate court so as to provide that the provisions disposing of the community property of the parties shall be effective upon the entry of the final decree of divorce. (Brown v. Brown (1960) 177 Cal. App. 2nd 387). . . For the reasons above stated, the trial court is directed to modify the interlocutory decree of divorce to provide that the provisions disposing of the parties community property shall be effective upon the entry of the final decree of divorce; the interlocutory decree, as so modified, is affirmed; . . ."

Arnold v. Arnold, Cal. App. Feb. 14, 1964 (unpublished) under Rule 976, Calif. Rules of Court) 1 Civil 21272

Thus, while the judgment was largely affirmed on appeal, the property-disposal provision of interest in the case at bar was modified to make ineffective until Final Judgment, thereby reversing its intent as an immediate transfer of title.

It is legally proper for the trial judge in a divorce suit to decree that whatever community property the husband may possess at the subsequent time of Final Decree shall then go to the wife --- IF no impediments have arisen in the meantime and IF the 'community property' is properly distinguished from 'community assets'. Such a judgment makes no attempt to possess or control the assets, or to transfer title immediately, or to nullify the rights of creditors; it would require no jurisdiction in rem for its validity, and offer no bar to confirmation of an Arrangement with Creditors involving community assets already held in custodia legis by the U.S. District Court.





VIII

The District Court of Appeal decision that the Superior Court held jurisdiction in rem over the community property after filing of Appellant's original petition under the Bankruptcy Act is erroneous, and should not be followed by this Court. Other decisions do not support it.

The only original appellate opinion on the question of jurisdiction in rem in this situation is the District Court of Appeal decision of Feb. 4, 1964, quoted above (p. 18) in part for its reversal of the property-disposal provisions of the Interlocutory Judgment, as premature. That quotation is preceded immediately by the following:

"Appellant's final contention on appeal from the interlocutory decree of divorce is that the court lacked jurisdiction in rem to make an award of the community property by reason of Appellant's having commenced a proceeding in federal court to obtain a creditors' arrangement subsequent to the commencement of the divorce proceeding but prior to entry of the interlocutory decree. This argument is untenable. Appellant concedes that his petition for a creditors' arrangement was not filed in the federal district court until June 19, 1962, some six months after the filing of the divorce action. Pursuant to 11 U.S.C.A., section 714, a court having jurisdiction of such a petition may enjoin or stay proceedings pending in other courts. Appellant did not apply for any such stay, and, to the contrary, wilfully concealed from the federal court the fact that divorce proceedings were pending against him. Under such circumstances, the mere filing of the petition for a creditors' arrangement was not in itself sufficient to divest the trial court

THE UNIVERSITY OF CHICAGO  
CHICAGO, ILLINOIS 60637  
U.S.A.  
TEL: (773) 835-3100  
FAX: (773) 835-3101

RECEIVED: 1998-01-15 10:00:00

It is a pleasure to inform you that your manuscript has been accepted for publication in the Journal of the American Chemical Society. The manuscript has been assigned to the Editor-in-Chief, who has recommended its publication. The manuscript will appear in the next issue of the Journal, which is scheduled for publication in the near future.

Very truly yours,  
[Signature]

The following information is provided for your information. The manuscript has been assigned to the Editor-in-Chief, who has recommended its publication. The manuscript will appear in the next issue of the Journal, which is scheduled for publication in the near future.

The manuscript has been assigned to the Editor-in-Chief, who has recommended its publication. The manuscript will appear in the next issue of the Journal, which is scheduled for publication in the near future.

The manuscript has been assigned to the Editor-in-Chief, who has recommended its publication. The manuscript will appear in the next issue of the Journal, which is scheduled for publication in the near future.

The manuscript has been assigned to the Editor-in-Chief, who has recommended its publication. The manuscript will appear in the next issue of the Journal, which is scheduled for publication in the near future.



court held that the mere pendency of proceedings in bankruptcy did not deprive the superior court of jurisdiction. (To the same effect, see Smith v. Thlegar (1951) 236 P. 2nd 749, 753-754.)"

Arnold v. Arnold, Feb. 14, 1964, 1 Civil 21272 (unpublished)

Paradoxically, the decision holds that the Superior Court could not properly make an immediately effective "award" (i.e., transfer of title) of the community property to Appellee, it nevertheless had the jurisdiction in rem to make such an "award" and on the strength of it later to evict Appellant from his debtor's estate and turn it over to Appellee. This contention is absurd, and finds no support whatever in prior court decisions, which uniformly uphold the paramount and exclusive jurisdiction in rem of courts of bankruptcy and recognize the filing of the original petition as an effective legal seizure of debtors' property. The difficulty lies in the meaning of the term "award", and in the differentiation between jurisdiction in rem and jurisdiction in personam.

The "award" which the trial judge attempted to make, and which the appellate court reversed by modification, was a transfer of title, and an immediate one requiring the Superior Court to hold jurisdiction in rem at the time of judgment, in order to control title and possession of the res; but such an "award" is not authorized by law as part of an Interlocutory Judgment of divorce. The "award" which the law permits, and which resulted from the appellate "modification" of the judgment in rem, is a personal judgment, requiring for its rendition only a jurisdiction in personam, and offering no interference with the proceedings in U.S. District Court and no threat to the rights of creditors; it states merely that, on Final Decree, the wife shall be given 100% of the residual community assets, after all debts are paid.



The legal "award" is tentative and dormant until Final Decree; then its implementation requires an evaluation of creditors' claims against the marital community, and their payment. Such claims may be evaluated in Superior Court, either by joining the creditors as defendants or by negotiating out-of-court payments with them; or by a separate legal proceeding such as that in U.S. District Court under the Bankruptcy Act, which Appellant elected to initiate. The Superior Court attempt to give the community assets to the wife and the debts to the husband finds no sanction in the law.

The Brazil v. Azevedo decision on which the District Court of Appeal based its nullification of the paramount and exclusive bankruptcy jurisdiction in rem of the U.S. District Court hardly suffices for so momentous a reversal of long-established law. It involved no res, no jurisdiction in rem, but only a personal suit for money against defendant Azevedo; the bankruptcy proceedings were not his own, but his partners' and his firm's. The District Court of Appeal comments that, in Brazil v. Azevedo,

"... the court held that the mere pendency of proceedings in bankruptcy did not deprive the superior court of jurisdiction."

The full quotation shows that jurisdiction in personam is meant:

"The pendency of these proceedings in bankruptcy did not deprive the superior court of jurisdiction of this cause where the suit was stayed under Section 11a of the Bankruptcy Act."

"This cause" was a personal suit for money against a solvent defendant, not a contest with the bankruptcy court for control of a debtor's assets, in fraud of creditors and outside the law. The law is clear:

"Where the judgment sought is strictly in personam, . . . both a state court and a federal court may proceed with the litigation.





But if the two suits are in rem or quasi in rem . . . requiring that the court . . . have control of the property which is the subject of one suit in order to proceed with the cause and to grant the relief sought, the jurisdiction of one court must of necessity yield to that of the other."

**Penn Genl. Casualty Co. v. Pa. (1935) 294 U.S. 189**

"We have held that a court of bankruptcy has exclusive and non-delegable control over the administration of an estate in its possession. . . Congress did not give the bankruptcy court exclusive jurisdiction over all controversies that in some way affect the debtor's estate. . . What it did give is exclusive jurisdiction of the debtor and its property . . . Any controversy involving that estate would have been within the exclusive jurisdiction of the bankruptcy court."

(Emphasis added)

**Callaway v. Benton (1948) 336 U.S. 132**

The District Court of Appeal decision seeks to invalidate and circumvent established Federal law by postulating the assumptions that

- (1) The Superior Court already held jurisdiction in rem at the time the original petition under the Bankruptcy Act was filed;
- (2) "Mere filing" of the petition did not divest the Superior Court of that jurisdiction in rem in view of Federal court abstention;
- (3) The circumstances of the case frustrate Federal jurisdiction, as
  - (a) The divorce was filed first, six months earlier than the Federal court petition for an Arrangement with Creditors;
  - (b) Appellant did not apply for a stay of Superior Court proceedings under 11 U.S. Code, Section 714;
  - (c) The pendency of the divorce action was not disclosed to the Referee.



11 three of these assumptions are erroneous and without force.

- (1) The Superior Court never took jurisdiction in rem by legal seizure; filing of a divorce action does not seize property;
- (2) Filing of the Arrangement petition did not divest the Superior Court of jurisdiction in rem, because it had none; filing did invoke the paramount and exclusive jurisdiction in rem under the Bankruptcy Act, displacing all other courts if need be.
- (3) The special circumstances of the case frustrate Federal jurisdiction, only in rare instances, of which this is not one. Nothing that Appellant did, or failed to do, could in any way weaken or nullify the powers given the U.S. District Court by Congress, so as to permit the Superior Court to acquire and hold an indivestible jurisdiction in rem, even with acquiescence by the Federal courts.
  - (a) Bankruptcy court jurisdiction in rem is paramount and exclusive, not concurrent, and displaces that of other courts; priority in time is without advantage.
  - (b) No stay of proceedings was called for until the Superior Court attempted to seize the debtor's estate on Feb. 15, 1963, and did so on March 20. The Referee denied the stay on erroneous grounds of comity and perplexity, on Feb. 21, 1963. Shortly afterward, a District Judge also denied a stay, and the District Court of Appeal denied prohibition.
  - (c) Non-disclosure of the divorce action -- a personal suit between spouses, immaterial and irrelevant to the proceeding in rem between husband and creditors ---in no way impairs the jurisdiction in rem of the U.S. District Court, since the divorce court could not transfer title to the real property.



...the ... of ...  
...the ... of ...  
...the ... of ...  
...the ... of ...  
...the ... of ...

...the ... of ...  
...the ... of ...  
...the ... of ...  
...the ... of ...  
...the ... of ...

...the ... of ...  
...the ... of ...  
...the ... of ...  
...the ... of ...  
...the ... of ...

...the ... of ...  
...the ... of ...  
...the ... of ...  
...the ... of ...  
...the ... of ...

...the ... of ...  
...the ... of ...  
...the ... of ...

on the point of jurisdiction in rem, the reasoning of the District Court of Appeal decision is wholly erroneous, and fails to justify its conclusion. Its reliance on the single case of *Brazil v. Azevedo* adds nothing to the validity of its contentions, since that case is not in point and does not deal with jurisdiction in rem at all. A second case cited,

*Smith v. Phlegar* (1951) 73 Ariz. 11, 236 Pac. 2nd 749

is also not in point, as it involves a lien foreclosure in which, unlike a divorce suit, the State court necessarily takes jurisdiction in rem on filing of the action and does not yield it to the bankruptcy court. (See p. 11, This Brief).

## IX

The Tenth Circuit decision in the case of *Panton v. Lee* correctly applies established jurisdictional law to the divorce-bankruptcy conflict; it should be followed here.

A precedent vastly superior to the District Court of Appeal decision in *Arnold v. Arnold* ---and one fully in accord with this Court's earlier opinion in *Hannah v. Swift* --- is afforded by an Oklahoma case decided in the Tenth Circuit,

*Panton v. Lee* (1958) 261 Fed. 2nd 183 (CA, 10th)

where under circumstances similar to those in the case at bar the court ruled in favor of the creditors and against the divorcing wife who sought to nullify creditors' claims against community assets.

"In bankruptcy proceeding of husband where divorced wife asserted claim to the (debtor's) estate on basis of a divorce decree entered less than a month before filing of the voluntary petition . . . and divorce decree did not attach as a judgment lien under Oklahoma law . . . The divorce decree gave the wife judgment "for one-half of





ceded the bankruptcy the question arises as to whether the general language of the decree had the effect in the circumstances of establishing a right in the wife to one-half of the bankrupt estate unencumbered by creditors' claims. . . The trustee took the property of the (debtor) subject to liens then existing and valid under the Bankruptcy Act and the laws of the state where the property was situated. Under Oklahoma law the wife had no lien. Hence, her claim cannot prevail over the rights of the trustee. . . The referee further held that the property division contained in the divorce decree had the purpose of defeating and defrauding the creditors of the husband and amounted to a legal fraud. . ."

In each case, the divorce action was filed before the voluntary proceeding under the Bankruptcy Act. In each, the divorce decree did not attach as a judgment lien: in *Panton v. Lee*, because of operation of Oklahoma law, and in *Arnold v. Arnold* because the Federal seizure preceded the interlocutory judgment of divorce. In neither case could a divorce action be used to give assets to a wife ahead of creditors.

The Superior Court "award" in the case at bar remained, after 'modification' on appeal, only what California law intended it to be: preliminary, tentative plan for disposal of residual community property (assets less debts) on Final Decree at some later time-- but with court, either State or Federal, protecting the rights of creditors. The Interlocutory Judgment was not a judgment in rem removing community assets from District Court custody, and could not bar confirmation of an arrangement a week later. Usurpation of jurisdiction by State courts and unwarranted abstention by Federal courts permit a divorcing wife to nullify the rights of creditors, but only unlawfully.

THESE ARE THE FIRST OF THE SEVEN VOLUMES OF THE HISTORY OF THE UNITED STATES OF AMERICA

BY JAMES MADISON  
VOLUME I  
FROM 1776 TO 1789  
NEW YORK: PUBLISHED BY J. B. ALLEN, 1821

THE HISTORY OF THE UNITED STATES OF AMERICA, FROM 1776 TO 1789, IN SEVEN VOLUMES. VOL. I.

THE HISTORY OF THE UNITED STATES OF AMERICA, FROM 1776 TO 1789, IN SEVEN VOLUMES. VOL. I.

THE HISTORY OF THE UNITED STATES OF AMERICA, FROM 1776 TO 1789, IN SEVEN VOLUMES. VOL. I.

THE HISTORY OF THE UNITED STATES OF AMERICA, FROM 1776 TO 1789, IN SEVEN VOLUMES. VOL. I.

THE HISTORY OF THE UNITED STATES OF AMERICA, FROM 1776 TO 1789, IN SEVEN VOLUMES. VOL. I.

THE HISTORY OF THE UNITED STATES OF AMERICA, FROM 1776 TO 1789, IN SEVEN VOLUMES. VOL. I.

THE HISTORY OF THE UNITED STATES OF AMERICA, FROM 1776 TO 1789, IN SEVEN VOLUMES. VOL. I.

THE HISTORY OF THE UNITED STATES OF AMERICA, FROM 1776 TO 1789, IN SEVEN VOLUMES. VOL. I.

THE HISTORY OF THE UNITED STATES OF AMERICA, FROM 1776 TO 1789, IN SEVEN VOLUMES. VOL. I.

THE HISTORY OF THE UNITED STATES OF AMERICA, FROM 1776 TO 1789, IN SEVEN VOLUMES. VOL. I.

THE HISTORY OF THE UNITED STATES OF AMERICA, FROM 1776 TO 1789, IN SEVEN VOLUMES. VOL. I.

THE HISTORY OF THE UNITED STATES OF AMERICA, FROM 1776 TO 1789, IN SEVEN VOLUMES. VOL. I.



part B: This Court's prior decision does not bar confirmation.

X

Affirmation on appeal of the Referee's order setting aside confirmation of a previous Arrangement was erroneous, and rested on an incorrect speculative view of the case.

The decision of this Court in the prior appeal (No. 18854) of the Referee's order filed Feb. 28, 1962, setting aside the Arrangement confirmed Oct. 30, 1962, under Section 386(2), Bankruptcy Act on ground that

"...fraud was practiced by the debtor ... in procuring the confirmation of the Arrangement heretofore made herein, by concealing from this Court all facts of his marriage and divorce in the Superior Court..."

was unfortunately vitiated by the obscure language used by Appellee's counsel in preparing the order for the Referee's signature. First, the fact of his marriage was not concealed at all: the real property is listed in Schedule B-1 of the debtor's original petition as "community property of petitioner and his wife". Second, what is meant by "concealing from this Court all facts of his ... divorce" is that the existence of the void, immaterial, and irrelevant Interlocutory Judgment of Oct. 22, 1962, purporting to transfer title ("award") the real property to Appellee was not disclosed to the Referee prior to confirmation. What was at issue then, as now, was the validity of the "award", the right of the Superior Court to transfer title by Interlocutory Judgment, the question of conflict of jurisdiction in rem. The Referee's order did not make clear -- as does his recent order of Nov. 10, 1964, denying confirmation -- that the only point at issue was the validity of the Inter-

The American Medical Association is a non-profit corporation organized for the purpose of promoting the interests of the medical profession and the public. It is organized into a national association and a number of state associations. The national association is organized into a number of departments, each of which is responsible for a particular phase of the work of the association. The state associations are organized into a number of departments, each of which is responsible for a particular phase of the work of the association. The American Medical Association is a non-profit corporation organized for the purpose of promoting the interests of the medical profession and the public. It is organized into a national association and a number of state associations. The national association is organized into a number of departments, each of which is responsible for a particular phase of the work of the association. The state associations are organized into a number of departments, each of which is responsible for a particular phase of the work of the association.

The American Medical Association is a non-profit corporation organized for the purpose of promoting the interests of the medical profession and the public. It is organized into a national association and a number of state associations. The national association is organized into a number of departments, each of which is responsible for a particular phase of the work of the association. The state associations are organized into a number of departments, each of which is responsible for a particular phase of the work of the association. The American Medical Association is a non-profit corporation organized for the purpose of promoting the interests of the medical profession and the public. It is organized into a national association and a number of state associations. The national association is organized into a number of departments, each of which is responsible for a particular phase of the work of the association. The state associations are organized into a number of departments, each of which is responsible for a particular phase of the work of the association.

locutory Judgment of divorce as an immediate transfer of title to community property. Appellant, believing then as he does now that the Superior Court could not lawfully transfer title to property held in custodia legis by the U. S. District Court, did not disclose to the Referee the immaterial point that the Superior Court judgment had been rendered. There was no 'fraud in procurement' calling for the use of Section 386, but only a question of validity of the State court judgment; the law is clear, and the Referee should have declared the judgment void.

The situation was further complicated by Appellee's Reply Brief, which inferentially denied that there was any question of jurisdiction in rem and validity of the Interlocutory Judgment re property, "It was never contended at any time, or at all, in the bankruptcy proceedings that this property was exclusively the property of the wife, since it could not have become her property until the Interlocutory period developed into a Final Judgment of Divorce." (p.2) However, Appellee's counsel had in fact objected to the jurisdiction of the District Court, and successfully, in opposing before the Referee the request of Appellant for an injunction against waste and damage to his debtor's estate, and well knew what was in the Referee's mind. The quoted statement from the Reply Brief (Nov. 15, 1963) concedes the lack of validity of the Interlocutory Judgment as a transfer of title.

This Court, misled by counsel's statements in the Reply Brief and the Referee's order, refused to consider the basic question of validity of the Superior Court judgment (or of jurisdiction in rem), and sought to explain the situation presented on appeal as follows:

- (1) Appellee's counsel had alleged the scheduled debts were outlawed.
- (2) The Referee found the debts were outlawed and not allowable, but neglected to make such a written finding.





tutory Judgment of Divorce as an immediate transfer of title to community property. Appellant, believing then as he does now that the Superior Court could not lawfully transfer title to property held in custodia legis by the U. S. District Court, did not disclose to the Referee the immaterial point that the Superior Court judgment had been rendered. There was no 'fraud in procurement' calling for the use of Section 386, but only a question of validity of the State court judgment; the law is clear, and the Referee should have declared the judgment void.

The situation was further complicated by Appellee's Reply Brief, which inferentially denied that there was any question of jurisdiction in rem and validity of the Interlocutory Judgment re property, "It was never contended at any time, or at all, in the bankruptcy proceedings that this property was exclusively the property of the wife, since it could not have become her property until the Interlocutory period developed into a Final Judgment of Divorce." (p.2) However, Appellee's counsel had in fact objected to the jurisdiction of the District Court, and successfully, in opposing before the Referee the request of Appellant for an injunction against waste and damage to his debtor's estate, and well knew what was in the Referee's mind. The quoted statement from the Reply Brief (Nov. 15, 1963) concedes the lack of validity of the Interlocutory Judgment as a transfer of title.

This Court, misled by counsel's statements in the Reply Brief and the Referee's order, refused to consider the basic question of validity of the Superior Court judgment (or of jurisdiction in rem), and sought to explain the situation presented on appeal as follows:

- (1) Appellee's counsel had alleged the scheduled debts were outlawed.
- (2) The Referee found the debts were outlawed and not allowable, but neglected to make such a written finding.



- (3) The confirmed Arrangement involved a new encumbrance of real property by Appellant, equivalent to a gift to his creditors.
- (4) Appellee's consent to such an encumbrance is required by Section 172a, Civil Code of California, on community real property.
- (5) Without Appellee's consent, the Arrangement is invalid, having been procured by fraud against Appellee, and should be set aside.

This view of the Referee's action may now be refuted, as follows:

- (1) The Reply Brief (p. 4) in the prior appeal asserts that debts incurred in the period 1951-58 were outlawed by 1962, citing the 4-year period in Section 337, Code of Civil Procedure, but overlooking Section 312 (which measures the 4-year period after the cause of action has accrued). As all attorneys know after a moment's reflection, a note outlaws 4 years after its date of maturity, not after its date of execution. Thus, a 10-year note executed in 1951 would outlaw in 1965, not 1955. All scheduled debts were allowable, not outlawed.
- (2) The Referee has never found the debts to be outlawed and not allowable. Recently, in a proposed order lodged with the Referee Oct. 30, 1964 (Clerk's Transcript, p. 23, paragraph VI), Appellee's counsel once again attempted to secure a finding that the scheduled debts were outlawed, but the Referee did not include the proposed finding in his order of Nov. 10, 1964, denying confirmation (Clerk's Tr., p. 31-33).
- (3) The proposed Arrangement is an encumbrance imposed on the community real property by the U.S. District Court for the benefit of creditors, not by a husband acting individually.
- (4) Section 172a, Civil Code, does not apply to a Court trustee, even if



...the ... of the ...  
...the ... of the ...  
...the ... of the ...  
...the ... of the ...

...the ... of the ...  
...the ... of the ...  
...the ... of the ...  
...the ... of the ...  
...the ... of the ...  
...the ... of the ...  
...the ... of the ...  
...the ... of the ...  
...the ... of the ...  
...the ... of the ...

...the ... of the ...  
...the ... of the ...  
...the ... of the ...  
...the ... of the ...  
...the ... of the ...  
...the ... of the ...  
...the ... of the ...  
...the ... of the ...  
...the ... of the ...  
...the ... of the ...

...the ... of the ...  
...the ... of the ...  
...the ... of the ...  
...the ... of the ...

he is a debtor in possession dealing with his own property.

(5) Appellee's consent is not necessary for validity of the Arrangement. Consequently, the prior Arrangement should not have been set aside, and the order on appeal, denying confirmation, should not have been made. The question at issue in both appeals, that of jurisdiction in rem, has not yet been decided correctly.

## XI

The scheduled debts were not outlawed, and no finding of the District Court holds them to be; if they were, the Arrangement would fall without use of Section 172a, Civil Code, and the proceeding would be dismissed.

The Referee's order denying confirmation quotes (Clerk's Tr. p. 33, 1.2) a portion of this Court's opinion in the prior appeal, No. 18854:

"Moreover, there was evidence which indicated that so-called "debts" might be barred by the statute of limitations. The plan arrangement provided for a second deed of trust on the community real property which was the home of the parties as security for appellant's "debts" to his brother and mother, thus converting unsecured debts into secured debts. The effect of this, since this is a voluntary petition on the part of appellant, is to place an encumbrance upon the community real property without the consent of the wife, which consent is required by Cal. Civ. Code Sec. 172a."

Yet, there was no evidence whatever indicating that any scheduled debts were outlawed, but only that certain unscheduled long-forgiven debts to Appellee's mother fell into this category. The debts involved in the arrangement were not outlawed, and the Referee's order made no such finding in response to the absurd contention of Appellee's counsel that



...the ... of ...  
...the ... of ...  
...the ... of ...  
...the ... of ...  
...the ... of ...

...

...the ... of ...  
...the ... of ...  
...the ... of ...  
...the ... of ...

...the ... of ...  
...the ... of ...  
...the ... of ...

...the ... of ...  
...the ... of ...  
...the ... of ...  
...the ... of ...

...the ... of ...  
...the ... of ...

...the ... of ...  
...the ... of ...

...the ... of ...  
...the ... of ...

...the ... of ...  
...the ... of ...

...the ... of ...

by note executed more than 4 years previously was outlawed. In the absence of evidence and findings, there should have been no retrial of doubtful issue of fact by this Court, with substitution of its judgment for that of the Referee and the District Judge.

*Weiby v. Farmers Mutual* (1960) 273 Fed. 2nd 327 (CA, 8th)

This Court has no power to make new findings of fact, even if the necessary evidence is available; in this case, the new finding was highly speculative, wholly unsupported by any evidence, and directly opposed to the Referee's view. The case should have been remanded to the District Court for explicit findings.

*Smallfield v. Home Ins. Co.* (1957) 244 Fed. 2nd 337 (CA, 9th)

*Irish v. United States* (1955) 225 Fed. 2nd 3 (CA, 9th)

*Deering-Milliken v. Modern-Aire* (1950) 231 Fed. 2nd 623 (CA, 9th)

In effect, the case previously appealed has now been remanded, and the Referee has refused to find the scheduled debts outlawed, but again finds the confirmation barred by the Superior Court judgment. Also, it should be noted that the question of outlawed debts is immaterial here since a debtor may waive the Statute of Limitations at his option, even over objections by his wife.

*Cunha v. Cunha* (1935) 8 Cal. App. 2nd 413, 48 Pac. 2nd 130

Both Referee and District Judge now hold that the prior decision of this Court bars confirmation of a new plan by requiring conformity to Section 172a, Civil Code, thus permitting Appellee to negate the rights of creditors by withholding her consent. However, the introduction of Section 172a into the case is dictum, unnecessary to the decision as made on the hypothesis that the debts were outlawed, and applicable only if that hypothesis were correct. Outlawed debts, not allowable, would require the dismissal of the entire proceeding, not

The first of these is the fact that the  
 government has been unable to raise the  
 necessary funds to meet its obligations.  
 This is due to a number of factors, including  
 the fact that the government has been unable to  
 collect the necessary taxes, and the fact that  
 the government has been unable to borrow the  
 necessary funds from the international market.  
 The second factor is the fact that the  
 government has been unable to implement the  
 necessary reforms to the economy. This has  
 led to a number of problems, including  
 inflation, unemployment, and a general  
 decline in the standard of living. The third  
 factor is the fact that the government has  
 been unable to maintain a stable political  
 environment. This has led to a number of  
 problems, including corruption, and a general  
 lack of confidence in the government.

toward a confirmed Arrangement. after elimination of some minor 'fraud in procurement'. Either debts not allowable or a wife's consent not forthcoming would be incurably fatal to all possible Arrangements; both are not needed in the same hypothesis.

## XII

Section 172a, Civil Code, is not properly a part of the law of this case, and cannot be invoked to bar an Arrangement by requiring the consent of a debtor's wife to encumbrance of real property by District Court order.

If the debts are outlawed, Section 172a is superfluous, as the proceeding can be dismissed for lack of creditors. If the debts are not outlawed, Section 172a is irrelevant, as State law cannot supersede Federal law to permit a wife to withhold community property from creditors in a proceeding under the Bankruptcy Act.

"...once the property is in the hands of the court, private rights as respect that res are subject to the superior dominion of the court and are to be adjudicated pursuant to the standards prescribed by Congress. Conditions precedent to enjoyment of the benefits of the Bankruptcy Act... cannot be provided except by Congress."

Case v. L.A. Lumber Co. (1939) 308 U.S. 106

Concerning a Texas law forbidding the husband to incur debts or dispose of community real property during the pendency of a divorce suit ---a statute much more stringent than Section 172a --- an opinion adopted by the Supreme Court of Texas says:

"This statute cannot be given the effect of denying to a party to



...the ... of ...  
...the ... of ...  
...the ... of ...

THE ...

...the ... of ...  
...the ... of ...  
...the ... of ...

...the ... of ...  
...the ... of ...  
...the ... of ...

...the ... of ...  
...the ... of ...  
...the ... of ...

...the ... of ...  
...the ... of ...  
...the ... of ...

...the ... of ...  
...the ... of ...  
...the ... of ...

a divorce suit the right to file a voluntary petition in bankruptcy. The Constitution of the United States vests in Congress the power to enact national bankruptcy laws. It has exercised that power and the laws on that subject are supreme. . . . The right of creditors cannot be defeated by agreements between husband and wife."

*Hornsby v. Hornsby* (1936) 127 Tex. 474, 93 SW 2nd 379

This Court has rejected the use of Section 172a and a similar Washington statute to enable a wife to take community assets in fraud of creditors.

*Hannah v. Swift*, *supra*

*Gibbons v. Goldsmith* (1915) 222 Fed. 826 (CA, 9th)

The Supreme Court of California has also limited the use of Section 172a to circumscribe its misuse by wives against creditors.

"...the wife is represented by the husband in suits by or against him involving the community property, and this, too, notwithstanding the provision of Section 172a of the Civil Code requiring her signature to a transfer of such property, and notwithstanding the further fact that a judgment in such an action may have the practical effect of a conveyance."

*Cutting v. Bryan* (1929) 206 Cal. 254, 274 Pac. 326

"... it may be inferred that the legislature intended that the husband . . . should retain the power to divest the spouses of their community property by his own act. . . so long as he does not make a gift of the community property without consideration. . ."

*Grolemund v. Cafferata* (1941) 17 Cal. 2nd 679, 111 Pac. 2nd 641

*Union Mutual Life Ins. Co. v. Broderick* (1925) 196 Cal. 497

Section 172a does not apply to an Arrangement proceeding, which is the telescoped equivalent of suit, seizure, judgment, execution sale, and reconveyance under encumbrance of the community real property.



very few persons are able to do this, and it is therefore not  
the usual way of proceeding. It is more common to have a  
number of small cells, each containing a single person, and  
the prisoners are allowed to move from one cell to another  
at will. This is the usual way of proceeding in the  
prisons of the United States. It is not, however, the  
usual way of proceeding in the prisons of the other  
countries of the world.

With these few exceptions, the  
prisoners are allowed to move from one cell to another  
at will. This is the usual way of proceeding in the  
prisons of the United States. It is not, however, the  
usual way of proceeding in the prisons of the other  
countries of the world. The prisoners are allowed to  
move from one cell to another at will. This is the  
usual way of proceeding in the prisons of the United  
States. It is not, however, the usual way of  
proceeding in the prisons of the other countries of  
the world. The prisoners are allowed to move from  
one cell to another at will. This is the usual way  
of proceeding in the prisons of the United States.  
It is not, however, the usual way of proceeding in  
the prisons of the other countries of the world.

The prisoners are allowed to move from one cell to another  
at will. This is the usual way of proceeding in the  
prisons of the United States. It is not, however, the  
usual way of proceeding in the prisons of the other  
countries of the world. The prisoners are allowed to  
move from one cell to another at will. This is the  
usual way of proceeding in the prisons of the United  
States. It is not, however, the usual way of  
proceeding in the prisons of the other countries of  
the world. The prisoners are allowed to move from  
one cell to another at will. This is the usual way  
of proceeding in the prisons of the United States.  
It is not, however, the usual way of proceeding in  
the prisons of the other countries of the world. The  
prisoners are allowed to move from one cell to  
another at will. This is the usual way of  
proceeding in the prisons of the United States.  
It is not, however, the usual way of proceeding in  
the prisons of the other countries of the world.

Myers v. Motley (1943) 318 U.S. 623

Thygesen v. Neufelder (1894) 9 Wash. 455, 37 Pac. 673

In re Pekin Plow Co. (1901) 112 Fed. 306 (CA , 8th)

Whether the original petition was voluntary or involuntary does not matter, as the proceedings thereafter are the same, as are the rights of creditors against the community property.

In re Clinton (1930) 41 Fed. 2nd 749 (DC, Calif.)

In re Fraizer (1902) 117 Fed. 746 (DC, Mo.)

In sum, there is no lawful basis for incorporating Section 172a, Civil Code, into proceedings under the Bankruptcy Act, either to protect her from her husband's acts or to enable her to frustrate his legitimate negotiations with his creditors to her unfair advantage.

### XIII

Affirmation on appeal of the application of Section 386(2), Bankruptcy Act, not only does not bar confirmation of an amended plan of arrangement, but serves only to correct technical errors and clear the way for confirmation of a new plan; it is not a terminal step.

The prior appeal, concerned solely with the setting-aside of the first confirmation, cannot result in a decision which bars every future confirmation by a dictum based on a mistaken view of the Referee's reasoning. Such an impasse violates the basic philosophy on which Section 386 rests --- in fact, makes it an absurdity in application because every subsequent arrangement must be denied confirmation for the same reason the first one was set aside. Section 386 is remedial, not punitive. The Referee, for reasons of comity and perplexity, has made the safe assumption that the Superior Court judgment in rem is valid, and looks to this Court for a clarifying decision, as does the District Judge.

CONTENTS

ORIGINAL ARTICLES

THE JOURNAL OF THE AMERICAN MEDICAL ASSOCIATION

Published by the American Medical Association

535 N. Dearborn Ave., Chicago, Ill., U.S.A.

Subscription price, Five Dollars per Annum in Advance

Single Copies, Fifteen Cents

Entered as Second-Class Matter, May 2, 1912

Postage Paid at Chicago, Ill.

Acceptance for mailing at Special Rate of Postage provided for in Act of October 3, 1917

Authorizes sale by mail at special rate of postage provided for in Act of October 3, 1917

Postmaster: This publication is published weekly except on Sundays and public holidays

Copyright, 1938, by American Medical Association

Printed at the Chicago Press, Chicago, Ill.

THE JOURNAL OF THE AMERICAN MEDICAL ASSOCIATION

In the prior appeal, this Court refused to consider the validity of the Superior Court judgment, which is now before the Court again, this time clearly stated, but complicated by the dictum of Section 172a.

Section 386 is remedial, not punitive, and does not serve to terminate a proceeding, but to renew it. The 'fraud in procurement' that it deals with is not irremediable or fatal to the proceeding. The Referee shows by his use of Section 386 that he meant the proceeding to go ahead if the obstacle of the Superior Court judgment could be overcome. (A quiet-title suit to test the validity of the judgments of State and Federal courts would have been preferable, since there was no remediable 'fraud in procurement' at issue but only the question of jurisdiction in rem.) Now that the false cries of "Fraud!!!" have abated, and the Referee's view of the matter is not obscured by extraneous and irrelevant diversionary arguments, a new decision from this Court, properly resolving the divorce-bankruptcy conflict in this Ninth Circuit, is in order.

## CONCLUSIONS

1. The Referee's Finding of Fact "That said Interlocutory Judgment and Decree of Divorce was affirmed on appeal in the District Court of Appeal of the State of California" is clearly erroneous, the sole provision material to this case -- the attempted immediate transfer of title to Appellee, contrary to law -- having been effectively reversed, not affirmed; in the words of the decision, "... the trial court is directed to modify the Interlocutory decree of divorce to provide that the provisions disposing of the parties' community property shall be effective upon the entry of the final decree of divorce..."

2. The Referee's Conclusion of Law that "The judgment of the Superior



CONTENTS  
ORIGINAL ARTICLES  
The Effect of the War on the Medical Profession  
The Medical Profession and the War  
The Medical Profession and the War  
The Medical Profession and the War

DEPARTMENTS  
The Medical Profession and the War  
The Medical Profession and the War  
The Medical Profession and the War  
The Medical Profession and the War

THE JOURNAL OF THE AMERICAN MEDICAL ASSOCIATION  
PUBLISHED WEEKLY  
CHICAGO, ILL., MAY 1, 1919  
Vol. 27, No. 19

CONTENTS  
ORIGINAL ARTICLES  
The Effect of the War on the Medical Profession  
The Medical Profession and the War  
The Medical Profession and the War  
The Medical Profession and the War

DEPARTMENTS  
The Medical Profession and the War  
The Medical Profession and the War  
The Medical Profession and the War  
The Medical Profession and the War

### ORIGINAL ARTICLES

The Effect of the War on the Medical Profession  
The Medical Profession and the War  
The Medical Profession and the War  
The Medical Profession and the War

THE JOURNAL OF THE AMERICAN MEDICAL ASSOCIATION  
PUBLISHED WEEKLY  
CHICAGO, ILL., MAY 1, 1919  
Vol. 27, No. 19

CONTENTS  
ORIGINAL ARTICLES  
The Effect of the War on the Medical Profession  
The Medical Profession and the War  
The Medical Profession and the War  
The Medical Profession and the War

Court... awarding the real property to Frances Kelly Arnold was valid and bars the involvement of said property in the arrangement.. " is erroneous, said judgment being invalid as a transfer of title for lack of jurisdiction in rem and valid only as a preliminary plan for implementation by Final Decree, and is a judgment in personam that cannot bar confirmation or nullify the rights of creditors unjoined as creditors in the divorce action.

3. The Referee's Conclusion of Law "That the debtor, J. Howard Arnold has no right title or interest in and to said property" is erroneous, since, as Debtor in Possession acting as trustee for the U.S. District Court he holds the legal title to the real property for the benefit of creditors, and has held it since seizure on June 19, 1962.

4. The Referee's Conclusion of Law "That confirmation of the proposed Amended Plan of Arrangement is barred by the decision of the Court of Appeals for the Ninth Circuit" is erroneous, said decision pertaining solely to the setting-aside of the previous confirmation and being based on a hypothetical and incorrect view of the Referee's view of the facts. The law of this case does not include Section 172a, Civil Code of California, and consent of a debtor's wife is not required in proceedings under the Bankruptcy Act.

5. The Referee's order denying confirmation of the Amended Plan of Arrangement is erroneous, and should be reversed to grant confirmation.

#### CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that in my opinion the foregoing brief is in full compliance with those rules.

Respectfully submitted,

*J. Howard Arnold*  
Appellant, pro se

dated: Sept. 22, 1965.





No. 20106

In the

United States Court of Appeals

*for the Ninth Circuit*

---

GREAT WESTERN BROADCASTING CORPORATION,  
d/b/a KXTV,

*Petitioner,*

vs.

NATIONAL LABOR RELATIONS BOARD,

*Respondent.*

---

On Supplemental Petition to Review a Supplemental Decision  
of the National Labor Relations Board

**Brief of American Federation of Television and Radio  
Artists, San Francisco Local; National Association  
of Broadcast Employees and Technicians,  
Local 55, Amici Curiae**

---

NEYHART & GRODIN

DUANE B. BEESON

1035 Russ Building

San Francisco, California

*Attorneys for Amici Curiae*

FILED

001 41965

FRANK H. SCHMID, CLERK



## INDEX

	Page
Interest of Amici Curiae.....	1
Statement of the Case.....	3
Argument .....	4
The Supreme Court's Decision in NLRB v. Fruit & Vegetable Packers, Local 760, fully supports the Dismissal of the Complaint irrespective of the proviso to Section 8(b)(4) of the Act .....	4
Introductory Statement .....	4
A. The Supreme Court's Decision in the Fruit & Vege- table Packers case requires that the Board's literal reading of Section 8(b)(4)(ii) be rejected.....	5
B. The opinion in Fruit Packers supports the contention that the peaceful handbilling in this case is constitu- tionally protected .....	8
Conclusion .....	9

## AUTHORITIES CITED

CASES	Pages
Lohman Sales Company, 132 NLRB 901.....	5
NLRB v. Fruit & Vegetable Packers, Local 760, 377 U.S. 58	
.....	4, 5, 6, 7, 8
NLRB v. Teamsters Local 639, 362 U.S. 274.....	7

## MISCELLANEOUS

National Labor Relations Act, as amended (61 Stat. 136, 73 Stat. 519, 28 U.S.C. 151, et seq.) :	
Section 8(b) (4) .....	3, 4, 7
Section 8(b) (4) (ii) .....	4, 5, 7, 8, 9
Section 8(b) (4) (ii) (B) .....	2, 6, 7
United States Constitution .....	2, 3

No. 20106

**In the**  
**United States Court of Appeals**  
*for the Ninth Circuit*

---

---

GREAT WESTERN BROADCASTING CORPORATION,  
d/b/a KXTV,

*Petitioner,*

vs.

NATIONAL LABOR RELATIONS BOARD,

*Respondent.*

---

On Supplemental Petition to Review a Supplemental Decision  
of the National Labor Relations Board

**Brief of American Federation of Television and Radio  
Artists, San Francisco Local; National Associa-  
tion of Broadcast Employees and Technicians,  
Local 55, Amici Curiae**

---

**INTEREST OF AMICI CURIAE**

Amici Curiae, hereafter called The Unions, were inter-  
venors in Case No. 17,698, the proceeding in which the origi-  
nal decision of the National Labor Relations Board was  
before this Court upon a petition to review filed by the



present petitioner.<sup>1</sup> The Unions' interest in the present case is the same as their interest in No. 17,698, namely, in presenting their position respecting a complaint issued against them which, although dismissed by the Board, is before the Court upon petitioner's request for an order reversing the dismissal and directing the Board to find the Unions guilty of unfair labor practices.

Although the Unions support the ruling of the Board in dismissing the complaint, their position on the legal issues presented is not identical with that of the Board. The Board on remand, in response to the Court's direction in Case No. 17,698, considered the contention advanced in this Court by the Unions to the effect that their conduct complained of did not constitute threats, coercion or restraint within the prohibition of Section 8(b)(4)(ii)(B) of the Act. The Board, however, rejected the Unions' position on this point, and argues in its brief before the Court (pp. 10-12) that the union activities under consideration are within the foregoing prohibitory language. Further, the Board on remand did not pass on the second question which the Court referred to it for "a determination as to the merits" (Pet. br. App., p. 36), namely, whether "The Union activity involved in this case is protected by the free speech and free press provisions of the First Amendment to the Federal Constitution" (*id.*). Instead, the Board reaffirmed its original dismissal of the complaint on the single ground that the union activity alleged in the complaint is excepted from interdiction under Section 8(b)(4)

---

1. The Unions filed a motion to intervene in the present proceeding, based principally on the fact that the Court had granted them status as intervenors in Case No. 17,698. Although the motion was unopposed, the Court denied intervention "without prejudice to the filing of briefs amici curiae". This brief is filed pursuant to the Court's allowance as stated in the order on the motion to intervene.

(ii) (B) of the Act by the so-called "publicity proviso" to that provision.<sup>2</sup>

The Unions fully agree with the Board's determination that their activities, as alleged in the complaint, are protected by the proviso to Section 8(b)(4) of the Act. The Unions also advance the two independent grounds in defense to the complaint that were argued by them in Case No. 17,698: (1) Their conduct does not fall within the scope of the "threaten, coerce, or restrain" language of Section 8(b)(4)(ii) (B) of the Act, and (2) in any event their conduct is protected by the First Amendment to the Constitution. Either of these contentions, if accepted, requires affirmance of the Board's dismissal order, irrespective of the ground relied on by the Board.

### STATEMENT OF THE CASE

The relevant facts are fully stated in this Court's decision in Case No. 17,698 (310 F.2d 591), are also summarized in the brief of Petitioner and the Board, and need not be repeated here. The issues before the Court, on the basis of the uncontested facts, this Court's original decision, and the Board's Supplemental Decision, are threefold: (1) whether the Unions' consumer boycott activities with

2. The proviso reads as follows:

"That for the purposes of this paragraph (4) only, nothing contained in such paragraph shall be construed to prohibit publicity, other than picketing, for the purpose of truthfully advising the public, including consumers and members of a labor organization, that a product or products are produced by an employer with whom the labor organization has a primary dispute and are distributed by another employer, as long as such publicity does not have an effect of inducing any individual employed by any person other than the primary employer in the course of his employment to refuse to pick up, deliver, or transport any goods, or not to perform any services, at the establishment of the employer engaged in such distribution."

respect to advertisers in connection with its strike against Petitioner are protected by the proviso to Section 8(b)(4) of the Act; (2) whether, assuming a negative answer to the first question, such activities are nonetheless outside the reach of Section 8(b)(4)(ii) of the Act; and (3) whether, assuming a negative answer to both of the forgoing questions, the activities in question are nonetheless within the protection of the First Amendment to the United States Constitution.<sup>3</sup>

The Unions support and adopt the argument of the Board with respect to the first of these questions (Bd.br. pp. 12-20). We reaffirm in this brief our position originally advanced in Case No. 17,698 with respect to the remaining two questions.

### **ARGUMENT**

#### **The Supreme Court's Decision in *N.L.R.B. v. Fruit & Vegetable Packers, Local 760*, Fully Supports the Dismissal of the Complaint Irrespective of the Proviso to Section 8(b)(4) of the Act**

*Introductory Statement*—The Unions have fully discussed in their brief in Case No. 17,698 the reasons in support of their contentions respecting the scope of Section 8(b)(4)(ii) of the Act and the protection afforded their activities by the Constitution. We respectfully refer the Court to our brief in that case rather than reiterate here the arguments made therein.<sup>4</sup> We limit discussion here to the

---

3. Petitioner advances a fourth procedural question in its brief: Whether the Board was foreclosed by the doctrine of "law of the case" from reaffirming its original dismissal of the complaint on the ground specified by it (Pet. br. 15-16). The Board correctly points out in its brief (pp. 20-21) that the doctrine has no application to this case.

4. Copies of the Unions' brief in No. 17,698 were, of course, filed with the Court and served on the parties at the time that case was before the Court. Additional copies will be filed and/or served on request.

application to these questions of the Supreme Court's decision in *N.L.R.B. v. Fruit & Vegetable Packers, Local 760*, 377 U.S. 58, handed down after the Court's decision in No. 17,698. We submit that this decision confirms the position of the Unions in their original brief.

**A. THE SUPREME COURT'S DECISION IN THE FRUIT & VEGETABLE PACKERS CASE REQUIRES THAT THE BOARD'S LITERAL READING OF SECTION 8(b)(4)(ii) BE REJECTED.**

The Board's original decision in this case treated the question of whether the Unions' conduct constituted threats, coercion and restraint within the meaning of Section 8(b)(4)(ii) of the Act by referring to its earlier ruling in *Lohman Sales Company*, 132 NLRB 901. The Board there reasoned that handbills distributed to the public and requesting a forbearance of trading with retailers who distributed the products involved in a primary strike would "threaten, restrain and coerce" the distributor because of the possibility of economic loss in the event that the public responded sympathetically to the appeal. The logic of the Board's position in this respect is unassailable if, but only if, the "threaten, restrain or coerce" language of Section 8(b)(4)(ii) was intended to be defined in terms of possible economic hardship resulting from a withdrawal of public patronage. The Supreme Court, however, has flatly rejected this approach to interpreting the statutory language.

Thus, the argument was made in the *Fruit Packers* case that picketing at Safeway retail stores to request the public not to purchase Washington State apples, the product involved in the primary labor dispute, constituted threats, coercion and restraint because of the economic hurt which the picketing sought to bring upon Safeway, for the purpose of compelling it to cease doing business with the apple packers against whom a strike was in effect. The argument

was disposed of by the Supreme Court in the following language (377 U.S. at 72-73):

“We disagree therefore with the Court of Appeals that the test of ‘to threaten, coerce, or restrain’ for the purposes of this case is whether Safeway suffered or was likely to suffer economic loss. A violation of Section 8(b)(4)(ii)(B) would not be established, merely because respondents’ picketing was effective to reduce Safeway’s sales of Washington State apples, even if this led or might lead Safeway to drop the item as a poor seller.”

Apparently in recognition of the foregoing, the Board in its Supplemental Decision does not rest its conclusion as to the scope of “threaten, coerce and restrain” on the possible or actual economic impact of the union conduct involved. Rather, the Board applies to the *handbilling* in this case the distinction which the Supreme Court drew in the *Fruit Packers* case with respect to *picketing*, i.e., between picketing which seeks “only to persuade customers not to buy the struck product” and picketing “to persuade customers not to trade at all” with the distributor of the struck product. 377 U.S. 58, at 72. The former was found not to be one of the evils which Congress wished to eliminate; the latter was found to have been outlawed. In short, the Board has equated picketing and handbilling for purposes of applying the “threaten, coerce and restrain” language of the statute, and has found the handbilling in this case to be an unfair labor practice because it was not limited, as it could not be, to products advertised on the struck television station. See Bd’s br., pp. 11-12.

The Board’s facile rule of equivalence is not in keeping with the sophistication which the *Fruit Packer’s* opinion requires in construing the words of art which Congress has



used in Section 8(b)(4)(ii). The opinion repeats the Court's admonition in *N.L.R.B. v. Teamsters Local 639*, 362 U.S. 399, 414, that the words "threaten, coerce and restrain" are not to be applied beyond the "isolated evils" which Congress meant to outlaw. 377 U.S. at 63. If, as the Supreme Court plainly indicated in *Fruit Packers*, evidence in legislative history of an intent to ban specific conduct as one of the "isolated evils" is prerequisite to a determination that the conduct falls within Section 8(b)(4)(ii), there is no escape from the conclusion that peaceful handbilling is beyond the pale of that provision. As detailed in the *Fruit Packers* opinion, explanations made in the committee reports and by the sponsors of the Senate and House bills do not reflect a legislative feeling that peaceful handbilling constitutes a practice which should be forbidden. Nor, as the Supreme Court explicitly held in *Fruit Packers*, does the circumstance that the publicity proviso to Section 8(b)(4) was added in conference following passage of the separate bills show that all economic activity by unions not exempted by the proviso automatically falls within the "threaten, coerce or restrain" language of Section 8(b)(4)(ii). 377 U.S. at 69. The point, rather, is that this language encompasses only the kind of union conduct which can be shown in the statute or its legislative history to be one of the 'isolated evils' spelled out by the Congress itself." 377 U.S. at 70. This showing cannot be made with respect to peaceful handbilling at establishments of distributors of a struck product, irrespective of whether the handbilling is limited to the product or seeks a general refusal to patronize the distributor. It follows that, irrespective of the application of the proviso, the activity of the Unions in the present case cannot be found prohibited by Section 8(b)(4)(ii)(B).

**B. THE OPINION IN FRUIT PACKERS SUPPORTS THE CONTENTION THAT THE PEACEFUL HANDBILLING IN THIS CASE IS CONSTITUTIONALLY PROTECTED.**

Although the Supreme Court did not pass on the constitutional question of whether Congress could validly outlaw peaceful consumer picketing, its opinion in *Fruit Packers* acknowledges that constitutional difficulties would arise from a literal reading of Section 8(b)(4)(ii) of the Act.<sup>5</sup> Thus, the Court explained that caution was essential in applying statutory interdictions to picketing because of the "concern that a broad ban against peaceful picketing might collide with the guarantees of the First Amendment." 377 U.S. at 63. Similarly, the Court alluded to portions of the legislative history of Section 8(b)(4)(ii) which reflected an intention not to forbid picketing or other communication that falls within "the constitutional right of free speech." 377 U.S. at 68, 69.

The respect which the Supreme Court has paid to the constitutional guarantees in a case involving picketing compels even greater deference in a case involving handbilling. It is scarcely open to question that the "sensitive area of peaceful picketing" is, in constitutional terms, more amenable to legislative restraint than peaceful handbilling.

In sum, the constitutional considerations which are brought to bear where, as here, Congress undertakes to regulate the peaceful distribution of written appeals for public support in a labor dispute have been given full recog-

---

5. Mr. Justice Black, reaching a different conclusion in the *Fruit Packers* case on the question of statutory construction, was required to deal with the constitutional question, and expressed the view that peaceful consumer picketing was constitutionally protected. 377 U.S. at 76-80. Mr. Justice Harlan, with whom Mr. Justice Stewart joined, concluded that such picketing could validly be restrained, because "picketing is 'inseparably something more [than] and different from simple communication,'" and because other non-picketing methods of communication are available. 377 U.S. at 93.

tion by the Supreme Court in dealing with Section 8(b)(4)(ii) of the Act. If nonliteral interpretation of the language of this provision is required to avoid the impact of the First Amendment in a case involving peaceful picketing, it follows that the language cannot constitutionally be applied to enjoin the less coercive activity of distributing handbills.

### CONCLUSION

For all of the foregoing reasons, as well as those stated in the Union's brief in Case No. 17,698, it is respectfully submitted that the Petition to Review should be denied.

September, 1965

NEYHART & GRODIN  
DUANE B. BEESON

*Attorneys for Amici Curiae*

### CERTIFICATE

The undersigned certifies that he has examined the provisions of Rules 18 and 19 of this Court, and in his opinion the tendered brief conforms to all requirements.

DUANE B. BEESON



---

IN THE  
**United States Court of Appeals**  
FOR THE NINTH CIRCUIT

---

**No. 20,106**

---

GREAT WESTERN BROADCASTING CORPORATION  
d/b/a KXTV, *Petitioner*,

v.

NATIONAL LABOR RELATIONS BOARD, *Respondent*.

---

**On Supplemental Petition to Review Supplemental Decision of  
the National Labor Relations Board**

---

**BRIEF OF THE NATIONAL ASSOCIATION OF BROADCASTERS AS AMICUS CURIAE, IN SUPPORT OF THE  
PETITIONER**

---

**NATIONAL ASSOCIATION OF BROADCASTERS**

**DOUGLAS A. ANELLO**

**GORDON C. COFFMAN**

*Counsel*

**1771 N Street, N. W.**

**Washington, D. C. 20036**





## SUBJECT INDEX

	Page
I. INTEREST OF AMICUS CURIAE .....	2
II. STATEMENT OF THE CASE .....	3
III. ARGUMENT .....	3
KXTV's only products were the programs distributed over its facilities to the general public and were neither handled nor distributed by KXTV's advertisers.	
IV. CONCLUSION .....	8

## AUTHORITIES CITED

### CASES:

<i>Federal Communications Commission v. Pottsville Broadcasting Co.</i> , 309 U.S. 134 .....	5
<i>Great Western Broadcasting Corp. v. N.L.R.B.</i> 310 F.2d 591 (C.A. 9) .....	3
<i>Johnston Broadcasting Company v. Federal Communications Commission</i> , 175 F.2d 351 .....	5
<i>National Broadcasting Co. v. United States</i> 319 U.S. 190 .....	5
<i>N.L.R.B. v. Fruit and Vegetable Packers and Warehousemen, Local 760 (Tree Fruits)</i> , 377 U.S. 58 ...	4
<i>N.L.R.B. v. Servette, Inc.</i> , 377 U.S. 46 .....	3, 4

### STATUTES:

Federal Communications Act (47 U.S.C. 301) .....	5
Federal Communications Act (47 U.S.C. 307(a)) ....	5
Federal Communications Act (47 U.S.C. 325(a)) ....	6
National Labor Relations Act (29 U.S.C. 158) .....	3, 4

### MISCELLANEOUS:

68 Cong. Rec. 2880 .....	6
2 Fed. Radio Commission Ann. Rep. 168 .....	7



IN THE  
**United States Court of Appeals**

FOR THE NINTH CIRCUIT

---

No. 20,106

---

GREAT WESTERN BROADCASTING CORPORATION  
d/b/a KXTV, *Petitioner*,

v.

NATIONAL LABOR RELATIONS BOARD, *Respondent*.

---

**On Supplemental Petition to Review Supplemental Decision of  
the National Labor Relations Board**

---

**BRIEF OF THE NATIONAL ASSOCIATION OF BROADCASTERS AS AMICUS CURIAE, IN SUPPORT OF THE  
PETITIONER**

---

This brief is filed with the written consent of the parties hereto, pursuant to rule 18(9)(a) of this Court. It is in support of the position of the Petitioner, Great Western Broadcasting Corp., d/b/a KXTV, and is in

opposition to the Supplemental Decision of the National Labor Relations Board issued on December 16, 1964, in response to this Court's decree of December 17, 1962, entered in the prior proceeding herein identified on the Court's records as No. 17,698.

### **INTEREST OF AMICUS CURIAE**

The National Association of Broadcasters (hereinafter called the Association) is a non-profit organization of radio and television broadcasters whose membership included as of November 3, 1965, 2135 AM stations, 915 FM stations, 455 Television stations, and all of the nationwide radio and television networks. This brief is submitted in furtherance of the objective of the Association which, in accordance with its by-laws,

“... shall be to foster and promote the development of the arts of aural and visual broadcasting in all its forms; to protect its members in every lawful and proper manner from injustice and unjust exactions; to do all things necessary and proper to encourage and promote customs and practices which will strengthen and maintain the broadcasting industry to the end that it may best serve the public.”

In the area of labor-management relations, the secondary boycott is of prime concern to broadcasters. The secondary boycott restrains and coerces broadcast stations through unfair economic pressure and seriously impairs their ability to pursue their legitimate business interests. Frequently, the economic injury suffered from a secondary boycott is far more lasting than the effects of a primary labor dispute. Thus, the Association has supported over the years numerous Congressional efforts to enact remedial boycott legislation and endorsed the enactment of the present secondary boycott sections of the Labor Management Relations Act of 1947, as amended in 1959 (herein-



after called the "Act").<sup>1</sup> It is the position of the Association that, through this legislation Congress has intentionally and effectively proscribed secondary boycotts of the nature here involved.

### STATEMENT OF THE CASE

The pertinent facts are fully stated in this Court's decision in Case No. 17,698 (310 F.2d 591). They are also summarized in the briefs of Petitioner and the Board and, therefore, need not be repeated here.

The basic issue before the Court is whether the Unions' consumer boycott activities with respect to advertisers in connection with their strike against Petitioner are protected by the proviso to Section 8(b)(4) of the Act.

The Association supports and adopts the arguments of the Petitioner as expressed both in its main and reply briefs. The basic purpose of this brief is to demonstrate that if there are products of a broadcaster which would satisfy the requirements of the Act, they are the programs put together and broadcast over his station's facilities and not the products *advertised* over those facilities.

### ARGUMENT

#### **KXTV's Only Products Were the Programs Distributed Over Its Facilities to the General Public and Were Neither Handled Nor Distributed by KXTV's Advertisers**

As stated in Petitioner's main brief (pp. 13-14) the Supreme Court in *N.L.R.B. v. Servette, Inc.*, 377 U.S. 46, did not suggest, nor did it imply, that a television station, or any other advertising medium, was a producer of the products advertised through its facilities. What products are produced are its programs.

---

<sup>1</sup> 61 Stat. 140, as amended in 1959, 73 Stat. 525, 29 U.S.C. 158.

In both of the cases relied upon by the Board<sup>2</sup> there were tangible products capable of distribution. The primary dispute in both instances was with the distributor of that product. The product which is a primary aspect of the dispute can be followed. On the other hand, where a primary employer provides only a service, not directly handling the product, there is nothing to be followed. The actual performance of the service is the only primary aspect involved, and this cannot be "distributed" by another employer. Thus, *Servette* and *Tree Fruits* continue the limitations of the proviso to 8(b)(4) of the Act to situations involving secondary boycotts where there is a forward flow of a product from the primary employer to the secondary employers.

When an advertiser engages the services of broadcast stations, there is no flow of product from the station to the advertiser. At this point there is no station product. Therefore, any publicity directed against an advertiser who uses the services of a broadcast station which has a primary dispute with a union to require him to stop doing business with the broadcast station, is a prohibited secondary boycott in its purest form as spelled out in Section 8(b)(4) of the Act.

This is not to say, however, that there is not a product connected with the activities of a broadcaster, and one which might have been boycotted by the unions had they chosen to do so. Radio and television stations produce very important products—programs. This product is not unlike that of other advertising media such as newspapers and magazines. It is the result of the physical efforts of the employees of a broadcasting company, just as newspapers and magazines are products of the employers who produce them.

---

<sup>2</sup> *N.L.R.B. v. Servette, Inc.*, 377 U.S. 46 and *N.L.R.B. v. Fruit and Vegetable Packers and Warehousemen, Local 760 (Tree Fruits)*, 377 U.S. 58.

However, a radio or television station differs in one very important respect from other advertising media. Radio and television stations, because of the peculiar nature of the air waves with which they operate, could not be allowed to develop helter-skelter solely on the basis of free enterprise. Congress determined at an early date that stations would first have to secure a license from a regulatory body established for that purpose to insure the orderly development of nationwide communications.<sup>3</sup> The primary concern today of the Federal Communications Commission in granting licenses to applicants is the way in which the applicant intends to operate in the "public interest, convenience, and necessity."<sup>4</sup>

The courts have, on numerous occasions, been called upon to determine the scope of the FCC's authority to define what is in the public interest. In each instance, it is evident that an important factor in that determination is the programming policy of each individual station. In comparative hearings involving two or more applicants for the same facility, the Federal Communications Commission cannot prescribe any type of program, but it can and does make a comparison on the basis of public interest, and, therefore, public service. In *Johnston Broadcasting Company v. Federal Communications Commission*, 175 F.2d 351, the Court said at page 359:

"But in a comparative consideration, it is well recognized that comparative service is the vital element, *and programs are the essence of that service*"<sup>5</sup> (Emphasis added).

It can thus be seen that the FCC recognizes the program to be the essential element of public interest and, therefore, the reason why radio and television stations

<sup>3</sup> 48 Stat. 1081, 47 U.S.C. 301.

<sup>4</sup> 48 Stat. 1083, as amended in 1962, 76 Stat. 58, 47 U.S.C. 307(a).

<sup>5</sup> See also: *National Broadcasting Co. v. United States*, 1943, 319 U.S. 190, 63 S. Ct. 997, 87 L. Ed. 1344; *Federal Communications Commission v. Pottsville Broadcasting Co.*, 1940, 309 U.S. 134, 138 n. 2, 60 S. Ct. 437, 84 L. Ed. 656.

are allowed exclusive use of a particular frequency within a specific, prescribed area. It can be said, then, that broadcast stations provide the public with an essential product, the program.

Another recognition of the program as the product of a broadcaster is found in the Communications Act itself. Section 325(a) provides in part: “. . . nor shall any broadcasting station rebroadcast the program or any part thereof of another broadcasting station without the express authority of the originating station.”<sup>6</sup>

The Congressional intent to preserve the property rights of the broadcasters was clearly spelled out in the enactment of Section 325(a). It recognized without equivocation the rights of a radio station in its programming. This is apparent from the following statement made by Senator Clarence C. Dill during floor debate on Section 28 of H.R. 9971<sup>7</sup>:

“As to Section 28, providing that no person, firm, or corporation shall rebroadcast the material broadcast by a station without the station’s consent, it is, I think, a very necessary provision. Otherwise we would have a broadcasting station spending a large amount of money to prepare and present a program as a program from that station, and then under the modern methods of rebroadcasting, it could be picked up and broadcast from the other stations . . .”<sup>8</sup>

The authors of the Radio Act of 1927 then, by providing protection for the program of one broadcaster as against unauthorized use by another broadcaster, were acknowledging the program as the product of a broadcaster’s labor.

A radio or television station prepares and distributes over its facilities programs identifiable as to content and

<sup>6</sup> 48 Stat. 1091, 47 U.S.C. 325 (a).

<sup>7</sup> Section 28 of H.R. 9971 was enacted as Section 28 of the Radio Act of 1927 and ultimately re-enacted as Section 325(a) of the Communications Act of 1934.

<sup>8</sup> 68 Cong. Rec. 2880 (1927).

length. Many stations spend great amounts of time and money to secure the right personnel who possess the special qualities needed to provide a unique service to the public. The programs, then, made up by co-ordinating the efforts of many individuals such as technicians, administrative personnel, directors, and performers, result in a product which is unique from all others.

This product, like a newspaper, is distributed to the public. A consumers' boycott of a radio or television program might be accomplished by direct appeal to the public informing them of the labor dispute and urging their assistance by not listening to the programs of the station in question.

That advertising was not to be, in and of itself, the primary object of broadcasting was emphasized early in the era of radio regulation:

“While it is true that broadcasting stations in this country are for the most part supported or partially supported by advertisers, broadcasting stations are not given these great privileges by the United States Government for the primary benefit of advertisers. Such benefit as is derived by advertisers must be incidental and entirely secondary to the interest of the public . . . Advertising should be only incidental to some real service rendered to the public, *and not the main object of a program*”<sup>9</sup> (Emphasis added).

Thus the advertising message of a sponsor is only an ingredient of the broadcaster's product. In other words, the program is the product and advertising is merely an element thereof. The proviso here in question applies only to the end product, the program, going forward and may not be applied backwards to reach the elements of the product. To apply the proviso to a boycott of the advertisers in this situation would be as erroneous as applying it to a boycott of a wheat mill where the primary dispute

---

<sup>9</sup> 2 Fed. Radio Commission Ann. Rep. 168 (1928).



was with the manufacturer of a cake mix which utilizes the raw flour of the wheat mill in its cake mix.

In the case at issue, the advertisers were not the people handling or distributing KXTV's products, the programs; therefore, the proviso would not protect the Unions' activity.

### CONCLUSION

Wherefore the Court should set aside the Board's Supplemental Decision, reverse the order of dismissal, and either enter a decree adopting the Recommended Order of the Trial Examiner or remand the matter to the Board for entry of an order consistent with this Court's legal conclusions in No. 17,698.

Respectfully submitted,

NATIONAL ASSOCIATION OF BROADCASTERS  
1771 N Street, N. W.  
Washington, D. C. 20036

DOUGLAS A. ANELLO  
GORDON C. COFFMAN  
*Counsel*

### CERTIFICATION

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

GORDON C. COFFMAN

November 9, 1965

IN THE  
**United States Court of Appeals**

FOR THE NINTH CIRCUIT

---

GREAT WESTERN BROADCASTING CORPORATION,  
d/b/a KXTV, *Petitioner*

v.

NATIONAL LABOR RELATIONS BOARD, *Respondent*

---

On Supplemental Petition to Review Supplemental Decision  
of the National Labor Relations Board

---

**REPLY BRIEF FOR PETITIONER**

---

WINTHROP A. JOHNS  
1120 Tower Building  
Washington, D. C. 20005

*Attorney for Great Western Broadcasting  
Corporation, d/b/a KXTV, Petitioner*

*Of Counsel:*

REILLY AND WELLS  
1120 Tower Building  
Washington, D. C. 20005



## AUTHORITIES CITED

	Page
<b>CASES:</b>	
International Brotherhood of Electrical Workers v. NLRB, 341 U.S. 694 .....	11
N.L.R.B. v. Fruit & Vegetable Packers & Warehouse- men Local 760 (Tree Fruits), 377 U.S. 58 ....	8, 9, 10, 11, 12, 13
N.L.R.B. v. Servette, Inc., 377 U.S. 46 .....	1, 2, 3, 4, 6, 7, 8
<b>MISCELLANEOUS:</b>	
Legisl. Hist. of the Labor-Management Reporting and Disclosure Act of 1959, vol. II, p. 1432 .....	9



IN THE  
**United States Court of Appeals**

FOR THE NINTH CIRCUIT

---

No. 20,106

---

GREAT WESTERN BROADCASTING CORPORATION,  
d/b/a KXTV, *Petitioner*

v.

NATIONAL LABOR RELATIONS BOARD, *Respondent*

---

**On Supplemental Petition to Review Supplemental Decision  
of the National Labor Relations Board**

---

**REPLY BRIEF FOR PETITIONER**

---

1. The Board's brief prompts petitioner to the conclusion that the pertinent language of the Supreme Court's decision in *Servette* (377 U.S. 46), relating to the publicity proviso, should be set forth verbatim herein in order to allow the Court properly to evaluate in context the meaning to be attached to the words used by the Supreme Court in that case. In petitioner's view, the Board has miscon-



strued the Supreme Court's meaning. The Supreme Court's statements (*ibid.*, at pp. 54-56), *in toto*, are as follows:

"[9] We turn finally to the question whether the proviso to amended § 8(b)(4) protected the Local's handbilling. [55] The Court of Appeals, following its decision in *Great Western Broadcasting Corp. v. Labor Board*, 310 F. 2d 591 (C.A. 9th Cir.), held that the proviso did not protect the Local's conduct because, as a distributor, Servette was not directly involved in the physical process of creating the products, and thus 'does not produce any products.' The Board on the other hand followed its ruling in *Lohman Sales Co.*, 132 N.L.R.B. 901, that products 'produced by an employer' included products distributed, as here, by a wholesaler with whom the primary dispute exists. We agree with the Board. The proviso was the outgrowth of a profound Senate concern that the unions' freedom to appeal to the public for support of their case be adequately safeguarded. We elaborated the history of the proviso in *National Labor Relations Board v. Fruit & Vegetable Packers, Local 760*, 377 U.S. 58, 84 S. Ct. 1063. It would fall far short of achieving this basic purpose if the proviso applied only in situations where the union's labor dispute is with the manufacturer or processor. Moreover, a primary target of the 1959 amendments was the secondary boycotts conducted by the Teamsters Union, which ordinarily represents employees not of manufacturers, but of motor carriers. There is nothing in the legislative history which suggests that the protection of the proviso was intended to be any narrower in coverage than the prohibition to which it is an exception, and we see no basis for attributing such an incongruous purpose to Congress.

"The term 'produced' in other labor laws was not unfamiliar to Congress. Under the Fair Labor Standards Act, the term is defined as 'produced, manufactured, mined, handled, or in any other manner worked on \* \* \*,' [56] 29 U.S.C. § 203(j), and has always been held to apply to the wholesale distribution of goods. The term 'production' in the War Labor Disputes Act

has been similarly applied to a general retail department and mail-order business. The Court of Appeals' restrictive reading of 'producer' was prompted in part by the language of § 8(b)(4)(B), which names as a proscribed object of the conduct defined in subsections (i) and (ii) 'forcing or requiring any person to cease \* \* \* dealing in the products of any other *producer*, *processor*, or *manufacturer*.' (Italics supplied.) In its decision in *Great Western Broadcasting Corp. v. Labor Board*, *supra*, the Court of Appeals reasoned that since a 'processor' and a 'manufacturer' are engaged in the physical creation of goods, the word 'producer' must be read as limited to one who performs similar functions. On the contrary, we think that 'producer' must be given a broader reach, else it is rendered virtually superfluous." (footnotes omitted.)

In the first place, the Board (Br., p. 14) lifts out of context the Supreme Court's statement, "We agree with the Board" (377 U.S., p. 55), thereby creating the impression that the Supreme Court had in *Servette* rejected this Court's conclusion that the advertising services of a television station did not make the station a producer of the advertiser's products. To the contrary, all the Supreme Court agreed with there was the Board's conclusion "that products produced by an employer included products distributed, as here [in that case], by a wholesaler" (*ibid.*). Nothing therein suggests that the Supreme Court was there holding that a television station, by advertising, helped "produce" the products it advertised.

The Board (Br., pp. 14-15) next lifts out of context the Supreme Court's *dictum* (377 U.S., p. 55) that—

"There is nothing in the legislative history which suggests that the protection of the proviso was intended to be any narrower in coverage than the prohibition to which it is an exception, and we see no basis for attributing such an incongruous purpose to Congress."

This statement of the Supreme Court is sandwiched between the statement that "a primary target" of the 1959

amendments of the Act was the boycott activities of the Teamsters Union, "which ordinarily represents employees not of manufacturers, but of motor carriers", and the Court's citation of other statutes to establish that the terms "produced" and "production" embrace "handled, or in any manner worked on" and have been applied to "wholesale" and "retail" "distribution of goods" (*supra*, pp. 2-3).

Read in the foregoing context of its holding that Congress must have intended a wholesale or retail distributor to be regarded as a "producer" of the products he distributes, the Supreme Court's dictum that the "protection of the proviso was [not] intended to be any narrower in coverage than the prohibition to which it is an exception" (*supra*) plainly is inapplicable here. The "prohibition" to which the publicity proviso is an "exception" is that part of Section 8(b)(4)(B) (see 377 U.S., p. 56; *supra*, p. 3) which prohibits certain conduct for "an object" of "forcing or requiring any person to cease using, selling, handling, transporting or otherwise dealing in the products of any other producer, processor, or manufacturer". As so limited, petitioner does not here question the Supreme Court's dictum.

However, as stated, in petitioner's main brief (pp. 13-14), the Supreme Court in *Servette* in no respect suggested, even by implication, that a television station, or any other advertising medium, was a producer of the products advertised through its facilities. It produces its own products, its programs (Main Br., p. 10).

Moreover, the "prohibition" of the statute under which petitioner claimed relief is that which proscribes conduct of the nature here involved for "an object" of "forcing or requiring any person \* \* \* to cease doing business with any other person" (Main Br., p. 4, fn. 8). Petitioner's charges and the General Counsel's Complaint all claimed relief under this prohibition of the Act (see O. R. 26, 4, 8,

14). The publicity proviso plainly is not an "exception" to the "doing business" "prohibition", unless by chance the "doing business" involves the distribution of a "product" "produced" by the "primary" employer (Pet. Br., pp. 4-5, fn. 8).

The fact that, after proscribing certain conduct for "an object" of "forcing or requiring any person to cease using," etc., "the products of any other producer, processor, or manufacturer", Congress also found it necessary to prohibit such conduct for the purpose of "forcing or requiring any person \* \* \* to cease doing business with any other person" (*supra*) fully discloses Congressional recognition that all secondary boycotts *do not* involve products of producers.

When the boycott does not involve a product of a producer, it is clear that Congress did not intend the proviso to be applicable. Had Congress intended the proviso to be applicable also to the "cease doing business" prohibition the proviso would have expressly so stated. Even better, Congress, if this were its intent as the Board here seems to argue, could have excluded from the prohibition of Section 8(b)(4)(B) *all* "publicity, other than picketing" which does not induce a secondary work stoppage in much simpler language than that contained in the proviso as enacted; for example, as follows:

"\* \* \* That for the purposes of this paragraph (4) only, nothing contained in this paragraph shall be construed to prohibit publicity, other than picketing, for an object proscribed in clause (B) thereof, as long as such publicity does not have an effect of inducing any individual employed by any person other than the primary employer in the course of his employment to refuse to pick up, deliver or transport any goods, or not to perform any services, at the establishment of a secondary employer."

Compare this all-encompassing language with the restricted proviso Congress, in fact, adopted.



Thus, contrary to the position of the Board, it is clear (1) that Congress recognized and prohibited two types of secondary boycotts, namely, (a) those directed at “products” of a “producer, processor, or manufacturer”, and (b) those directed at business relations which did not involve “products” of “a producer, processor, or manufacturer”; (2) that the publicity proviso is an exception only to the prohibition against secondary boycotts directed at “products” of a “producer, processor, or manufacturer”; (3) that the products of advertising media are not the products which are advertised through their facilities, but they are their own products—in the case of newspaper and magazine publishers, the newspapers and magazines themselves; in the case of television and radio stations, the programs televised and broadcast to customers and the public—which products are capable of being boycotted with impunity under the proviso (Main Br., pp. 9-10—the Board has offered nothing which would explain away this obvious flaw in its reasoning to the result it reached in this matter);<sup>1</sup> (4) that all the Supreme Court meant in *Servette* was that the proviso was not “intended to be any narrower in coverage than the prohibition” against secondary boycotts of “products of any other producer, processor, or manufacturer”; (5) that a television station, unlike a wholesaler, has not “handled, or in any other manner worked on” the products of its advertisers enroute to the market place; and (6) that the Supreme Court in *Servette* held merely that “‘producer’ must be given a broader reach” than manufacturer” and encompass an employer, like a wholesaler, who has “handled” the product on the way to the place where it is being distributed (*supra*, p. 2).

---

<sup>1</sup> The Board's brief in the instant review proceeding (p. 12) states that “the question is whether a television station, like KXTV, in performing an advertising service, can be deemed to be the ‘producer’ of a ‘product or products.’ ” This begs the question. Of course, it is a producer of a product or products. But the product it produces is the program it puts together and sends out over its assigned wave-length or channel, not the product of someone else who utilizes its programs and their transmission to advertise its own products.

2. The argument of the Board (Br., pp. 15-16) that, because Section 8(b)(4)(B) prohibits secondary boycotts by "means other than publicity" against a radio or television station, "it would follow that, where the means specified in the proviso are utilized, *the proviso privileges the secondary activity irrespective of the function performed by the primary employer*" (emphasis added), is contrary to reason and to the Supreme Court's holding in *Servette*. Simply because secondary boycotts against such stations by "means other than publicity" are clearly unlawful, it does not mean that all secondary boycotts against such stations conducted by "publicity" are privileged under the proviso "irrespective of the function performed" by the station. The Supreme Court in *Servette* made extremely clear that in order for the proviso to apply the function of the primary employer had to be that of a "producer" of the product, and encompassed within that term only those who have physical contact with the product by handling or in some manner working on it (*supra*, pp. 2-3).

3. The untenable position of the Board in this matter is further illustrated by its claim before this Court (Bd. Br., pp. 17-18) that, under the Supreme Court's decision in *Servette*, the publicity proviso permits a union to back-track from the wholesaler, or distributor, to the manufacturer. In other words, the Board contends before this Court, in effect, that a union which has a dispute with a *distributor* of a product in one isolated community could, under the proviso, pursue the *manufacturer* of that product to the hundreds, or thousands, of outlets it has all over the country and boycott, not the few products of that *manufacturer* "handled" by the *struck distributor*, but the products of the *manufacturer* "handled" by its hundreds, or thousands, of *other distributors* throughout the country.

*Servette* did not so hold (*supra*, pp. 2-3). It held merely that "products 'produced by an employer' included products distributed, as here [in that case], by a whole-



saler” (*supra*, p. 2), relying for this holding on definitions which state that “produced” includes “handled, or in any other manner worked on.” But the only portion of a manufacturer’s product “handled”, etc., by a wholesaler is that portion which passes through his hands on the way to the customer. Under *Servette*, this portion of the manufacturer’s product is the only portion which may be boycotted with impunity under the proviso.

The Board cites no case supporting its position here, and petitioner knows of none. In fact, petitioner, in its main brief (p. 10), in this connection called this Court’s attention to footnote 7 in the *Tree Fruits* decision (337 U.S., at p. 64) which states—

“The distinction between picketing a secondary employer merely to ‘follow the struck goods,’ and picketing designed to result in a generalized loss of patronage, was well established in the state cases by 1940. The distinction was sometimes justified on the ground that the secondary employer, who was presumed to receive a competitive benefit from the primary employer’s nonunion, and hence lower, wage scales, was in ‘unity of interest’ with the primary employer, *Goldfinger v. Feintuch*, 276 N.Y. 281, 286, 11 N.E. 2d 910, 913, 116 A.L.R. 477; *Newark Ladder & Bracket Sales Co. v. Furniture Workers Union Local 66*, 125 N.J. Eq. 99, 4 A. 2d 49; *Johnson v. Milk Drivers & Dairy Employees Union, Local 854*, 195 So. 791 (Ct. App. La.), and sometimes on the ground that picketing restricted to the primary employer’s product is ‘a primary boycott against the merchandise.’ *Chiate v. United Cannery Agricultural Packing & Allied Workers of America*, 2 CCH Lab. Cas. 125, 126 (Cal. Super. Ct.). See *I Teller, Labor Disputes and Collective Bargaining* § 123 (1940).”

This footnote plainly is inconsistent with the contention of the Board here. “Follow”, certainly does not mean “back-track”. Goods become “struck” only after they are in the hands of the “struck” employer. The “competitive benefit from the primary employer’s nonunion, and hence

lower wage scales" can be obtained only by a "secondary employer" who receives the goods *after* they have left the hands of the primary employer.

There is nothing in the legislative history on the proviso which remotely suggests that the legislators desired to do more than protect the traditional *following* of "struck goods" referred to in the above quoted footnote from the *Tree Fruits* case. See, for example, the report of Senator Kennedy, spokesman for the Senate conferees, to the Senate on the proviso. *Legisl. Hist. of the Labor-Management Reporting and Disclosure Act of 1959*, vol. II, p. 1432 (1).

What the Board in this respect seems to be claiming is that a wholesaler who "handled" as little as one-thousandth of one percent of the products of a manufacturer became the "producer" of all the manufacturer's products. Necessarily, the Board also is saying that the proviso privileges the union having a dispute with *any* employer who "handled" the manufactured product to back-track and induce customer boycotts of the *ingredients* of the manufactured product from the point of origin of each ingredient through each stage of processing regardless of the number of employers through whose hands the ingredients may pass before being "handled" in manufactured form by the *primary* employer in the labor dispute. But neither of these claims is any more startling than the Board's contention, in its original decision and its Supplemental Decision, which latter is here under review, that a television station by advertising "automobiles, bread, gasoline and beer", and "banking and cleaning services", becomes a "producer" of these items.

4. The Board in its brief (pp. 19-20, fn. 17) refers to a number of decisions under the Fair Labor Standards Act. But, as the Board itself apparently recognizes (*ibid.*), these decisions are wholly irrelevant to the issue here. Those cases interpret an express provision of the FLSA (Sec.

3(j); 29 U.S.C. Sec. 203(j)) making the requirements of the FLSA applicable to "employees" engaged in work necessary to the production of goods for commerce. What is at issue here, however, is whether a television station is a "producer" of the products advertised over its facilities. Moreover, while television advertising may be necessary to the *production of customers for goods* produced, it clearly is *not necessary* to the *production of the goods* themselves. A reading of the cited decisions makes clear their inapplicability in the instant matter.

5. The brief of the Unions, *amici curiae* (pp. 5-9), relies exclusively on the Supreme Court's decision in *Tree Fruits* (377 U.S. 58) for the contentions (1) that "peaceful hand-billing is beyond the pale" of the Section 8(b)(4) mandate against "threaten, coerce, or restrain" (Br., p. 7), and (2) that a restraint of handbilling in the instant matter would be an abridgement of "the constitutional right of free speech" (Br., pp. 8-9). Neither of these contentions is supported by the *Tree Fruits* or any other decision.

In respect to the Unions' first contention, the *Tree Fruits* decision holds merely that the proviso excludes from the ban of "threaten, coerce, or restrain" "picketing which only persuades [the secondary employer's] customers not to buy the struck product" (377 U.S., p. 70) because, "if the appeal succeeds, the secondary employer's purchases from the struck firms are decreased only because the public has diminished its purchases of the struck product. On the other hand, when consumer picketing is employed to persuade customers not to trade at all with the secondary employer, the latter stops buying the struck product, not because of a falling demand, but in response to pressure designed to inflict injury on his business generally" (377 U.S., p. 72, 63). As to "publicity other than picketing", the Court held that the "Senate conferees' doubts led Congress", in the proviso, to "authorize publicity other than picketing which persuades the customers of a secondary employer to stop all trading with him" (377 U.S., p. 72). *But this means, under the Tree Fruits decision, to "refrain*

from trading with a retailer who sells [nonunion or struck] goods" (377 U.S., p. 70). The Court did not hold that handbilling was not "coercive". To the contrary, the Court particularly stated that the "proviso" provided safeguards for "conduct which might be 'coercive'" (377 U.S., p. 69).

It is thus plain that in *Tree Fruits* all the Supreme Court stated was that a Union could handbill a secondary employer dealing in a "struck product" to persuade customers to cease doing business with him at all because that was the way the Court read the exception to "threaten, coerce, or restrain" contained in the proviso in respect to "products . . . produced" by a struck employer.<sup>2</sup> The Court did not hold that handbilling is "beyond the pale" of Section 8(b)(4) because not within the proscription of "threaten, coerce, or restrain".

As the Supreme Court noted in *International Brotherhood of Electrical Workers v. N.L.R.B.*, 341 U.S. 694 (Main Br., pp. 18-19), in construing words like "threaten, coerce, and restrain"—there, "induce and encourage"—it is "the end sought" not the "means used" that is determinative (at p. 702). Applying that principle in *Tree Fruits* (see 377 U.S., p. 68), the Court held that publicity [there picketing] to persuade "customers to cease buying the product of the primary employer" is not within the ban of "threaten, coerce, and restrain" because, "if the appeal succeeds, the secondary employer's purchases from the struck firms are decreased only because the public has diminished its purchases of the struck product" (377 U.S., at p. 72). However, as the Court went on to hold—

"... when consumer picketing is employed to persuade customers not to trade at all with the secondary employer, the latter stops buying the struck product, not because of a falling demand, but in response to pressure designed to inflict injury on his business generally. In such case, the union does more than merely follow

---

<sup>2</sup> Here, of course, this Court has held that petitioner is not the producer of its advertisers' products and the proviso, therefore, is inapplicable.



the struck product;<sup>3</sup> it creates a separate dispute with the secondary employer.”

As the Court in *Tree Fruits* had previously noted (377 U.S., pp. 68, 63), the “isolated evil” Congress was concerned with in Section 8(b)(4)(B) was the prohibition of “coercive \* \* \* conduct, whether it be picketing or otherwise”, “to cut off the business of a secondary employer as a means of forcing him to stop doing business with the primary employer”.<sup>4</sup>

The “pressure” to “persuade customers not to trade at all with the secondary employer” may as readily be accomplished by handbills or word of mouth, as here,<sup>5</sup> as by peaceful picketing. As the Supreme Court in *Tree Fruits* stated (377 U.S., p. 68), “the prohibition of § 8(b)(4) is keyed to the coercive nature of the conduct, whether it be picketing or otherwise”.

Having found in its Supplemental Decision (S.R. 86) that the Unions’ “activities were directed towards the institution of a consumer boycott of all products distributed by the companies it listed as advertising on KXTV”, the Board properly found further, under *Tree Fruits*, that the Unions’ “conduct clearly constitutes threats, restraint, or coercion within the meaning of Section 8(b)(4)(ii) of the Act”.

The Unions’ second contention, that a restraint of hand-billing in the instant matter would, under *Tree Fruits*, un-

---

<sup>3</sup> Note again the Supreme Court’s reference in *Tree Fruits* to “follow” and “struck product” (see *supra*, pp. 8-9).

<sup>4</sup> The Unions’ apparent argument (Br., p. 7) that *Tree Fruits* means that there must be “evidence in legislative history of an intent to ban *specific conduct* as one of the ‘isolated evils’ ” (emphasis added), misinterprets the Supreme Court’s decision. In *Tree Fruits*, all the Court held was that before picketing or other forms of free speech only could be enjoined it must appear that it was for the “‘isolated evil’ believed [by Congress] to require proscription” (377 U.S., p. 63).

<sup>5</sup> As this Court noted in its original decision herein (Main Br., p. 25), “one KXTV advertiser was subjected to a secondary boycott and at least two other advertisers ceased doing business with that station”.

constitutionally abridge free speech, is likewise without substance.

The Unions' brief, without pointing to any specific justification therefor in *Tree Fruits*, suggests (pp. 8-9) that there is a constitutional difference between "peaceful picketing" and "peaceful handbilling" which makes the former "more amenable to legislative restraint than" the latter. However, as petitioner reads the *Tree Fruits* case, the Court made no distinction between the two. Thus, at one point the Court noted the argument that the "public will \* \* \* neither read the [picket] signs and *handbills*" \* \* \* (377 U.S., p. 71; emphasis added). At another point it expressly stated that "the prohibition of § 8(b)(4) is keyed to the coercive nature of the conduct, *whether it be picketing or otherwise*" (377 U.S., p. 68; emphasis added). The "coercive nature of the conduct" was repeatedly identified in the decision, in substance, as "conduct" "to persuade the customers of a secondary employer to cease trading with him in order to force him to cease dealing with, or to put pressure upon, the primary employer" (377 U.S., pp. 63, 68, 70-71, 72).

Thus, the Supreme Court necessarily having found in *Tree Fruits* that picketing to persuade customers of a secondary employer to cease all trade with him to force him to discontinue handling the products of the primary employer is a constitutional exercise of the Congressional power, and the Court having therein drawn no distinction between the Congressional power in respect to picketing and other forms of speech, or suggested a reversal of its prior decisions cited by petitioner (Main Br., pp. 16-19), it follows that the handbilling here for an object proscribed in *Tree Fruits* also is within the Congressional authority.

**If this were not so, petitioner would have great difficulty in understanding the need for the Supreme Court's decision in *Servette*, relating to handbills, issued the same day as *Tree Fruits*. Nor can petitioner understand the need for the *Servette* decision if "handbilling" is not within the proscription of "threaten, coerce, or restrain"—the Unions' first contention.**



# CONCLUSION

Wherefore, it is clear that the Board and the Unions have shown no reason why this Court should not here reaffirm its holding on the facts of this case in the original review proceeding (No. 17,698) and grant the relief requested in petitioner's main brief (pp. 19-20).

Respectfully submitted,

WINTHROP A. JOHNS  
1120 Tower Building  
Washington, D. C. 20005

*Attorney for Great Western Broadcasting  
Corporation, d/b/a KXTV, Petitioner*

*Of Counsel:*

REILLY AND WELLS  
1120 Tower Building  
Washington, D. C. 20005

# Certification

I certify that, in connection with the preparation of this reply brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing reply brief is in full compliance with those rules.

/s/ WINTHROP A. JOHNS  
Winthrop A. Johns  
*Attorney for Petitioner*

October 28, 1965

No. 20106

---

**In the United States Court of Appeals  
for the Ninth Circuit**

---

**GREAT WESTERN BROADCASTING CORPORATION,  
d/b/a KXTV, PETITIONER**

*v.*

**NATIONAL LABOR RELATIONS BOARD, RESPONDENT**

---

**ON SUPPLEMENTAL PETITION TO REVIEW A SUPPLEMENTAL  
DECISION OF THE NATIONAL LABOR RELATIONS BOARD**

---

**BRIEF FOR THE NATIONAL LABOR RELATIONS BOARD**

---

**ARNOLD ORDMAN,**

*General Counsel,*

**DOMINICK L. MANOLI,**

*Associate General Counsel,*

**MARCEL MALLET-PREVOST,**

*Assistant General Counsel,*

**NORTON J. COME,**

*Assistant General Counsel,*

**MICHAEL N. SOHN,**

*Attorney,*

*National Labor Relations Board.*

---

**FILED**

**SEP 25 1965**

**FRANK H. SCHMID, CLERK**



# INDEX

	Page
Jurisdiction-----	1
Counterstatement of the case-----	2
I. The earlier Board and Court decisions-----	2
II. The Supplemental Board decision-----	4
Argument-----	5
The Union's activity was protected by the public- ity proviso to Section 8(b) (4)-----	5
A. The Supreme Court decisions in <i>Servette</i> and <i>Fruit and Vegetable Packers</i> -----	5
B. Under the foregoing principles, the Unions' activity here, although constituting threats, coercion, or restraint within the meaning of Section 8(b) (4) (ii), was saved by the pub- licity proviso-----	10
C. The "law of the case" doctrine is inappli- cable-----	20
Conclusion-----	22
Appendix A-----	23
Appendix B-----	25

## AUTHORITIES CITED

### Cases:

<i>Bozant v. Bank of New York</i> , 156 F. 2d 787 (C.A. 2) --	20
<i>City of Seattle v. Puget Sound Power &amp; Light Co.</i> , 15 F. 2d 794 (C.A. 9)-----	20-21
<i>Columbia Broadcasting System, Inc. v. Amana Refrig- eration, Inc.</i> , 295 F. 2d 375 (C.A. 7), cert. den., 369 U.S. 812-----	20
<i>Comm. of Internal Revenue v. Netcher</i> , 143 F. 2d 484 (C.A. 7)-----	21
<i>Goldstein v. Dabanian</i> , 291 F. 2d 208 (C.A. 3)-----	20
<i>Higgins, et al. v. Calif. Prune &amp; Apricot Growers, Inc.</i> , 3 F. 2d 896 (C.A. 2)-----	21

## Cases—Continued

<i>Hoffman v. Typographical Local 37</i> , 59 LRRM 2983 (D. Hawaii)-----	Page 16
<i>Kirschbaum v. Walling</i> , 316 U.S. 517-----	20
<i>Local Union 154, Int'l Typographical Union (Ypsilanti Press)</i> , 135 NLRB 991-----	16
<i>Local 901, Teamsters v. Compton</i> , 291 F. 2d 793 (C.A. 1)-----	16
<i>Lohman Sales Co.</i> , 132 NLRB 901-----	13, 14
<i>Luminous Unit Co. v. Freeman Sweet Co.</i> , 3 F. 2d 577 (C.A. 7)-----	21
<i>Maryland Casualty Co. v. City of South Norfolk, et al.</i> , 54 F. 2d 1032 (C.A. 4)-----	21
<i>Middle South Broadcasting Co.</i> , 133 NLRB 1698---	13
<i>Mitchell v. Dooley Bros., Inc.</i> , 286 F. 2d 40 (C.A. 1)---	20
<i>N.L.R.B. v. Associated Musicians (Gotham Broadcast- ing Co.)</i> , 226 F. 2d 900 (C.A. 2), cert. den., 351 U.S. 962-----	16
<i>N.L.R.B. v. Fruit &amp; Vegetable Packers, Local 760</i> , 377 U.S. 58-----	5, 6, 7, 9, 11, 19, 21
<i>N.L.R.B. v. Joint Council of Teamsters</i> , 338 F. 2d 23 (C.A. 9)-----	15
<i>N.L.R.B. v. Servette, Inc.</i> , 377 U.S. 46-----	4, 5, 8, 9, 10, 13, 14, 15, 16, 17, 18, 19, 20, 21
<i>Pacific American Fisheries v. Hoof</i> , 291 Fed. 306----	21
<i>Pennsylvania v. Wheeling &amp; Belmont Bridge Co.</i> , 18 How (59 U.S.) 421-----	21
<i>Public Bldg. Authority of Birmingham v. Goldberg</i> , 298 F. 2d 367 (C.A. 5)-----	20
<i>Servette, Inc. v. N.L.R.B.</i> , 310 F. 2d 659 (C.A. 9)----	4
<i>Simmons Co. v. Grier Bros. Co.</i> , 258 U.S. 82-----	20
<i>System Federation No. 91 v. Wright</i> , 364 U.S. 642---	21
<i>Teamsters, Local 901 ("Editorial Imparcial")</i> , 134 NLRB 895-----	16
<i>Union Nat'l Bank of Little Rock v. Durkin</i> , 207 F. 2d 848 (C.A. 8)-----	20
<i>White v. Higgins</i> , 116 F. 2d 312 (C.A. 1)-----	21
<i>Zdanok v. Glidden</i> , 327 F. 2d 944 (C.A. 2), cert. den., 377 U.S. 934-----	21

## Statutes:

Fair Labor Standards Act (29 U.S.C. § 203(j)):	Page
Section 203(j)-----	19
National Labor Relations Act, as amended (61 Stat. 136, 73 Stat. 519, 29 U.S.C., Sec. 151, <i>et seq.</i> ):	
Section 8(b)(4)-----	4, 5, 19, 20
Section 8(b)(4)(i)(B)-----	8
Section 8(b)(4)(ii)(B)-----	2, 4, 10, 13, 14
Section 8(e)-----	15
Section 10(f)-----	2

## Miscellaneous:

1B Moore, <i>Federal Practice</i> (2d ed. 1965) Sec. 6.404[10], p. 575-----	21
Note, <i>Law of the Case</i> , 5 Stanford L. Rev. 751, 765--	21





# **In the United States Court of Appeals for the Ninth Circuit**

---

No. 20106

---

GREAT WESTERN BROADCASTING CORPORATION,  
d/b/a KXTV, PETITIONER

v.

NATIONAL LABOR RELATIONS BOARD, RESPONDENT

---

*ON SUPPLEMENTAL PETITION TO REVIEW A SUPPLEMENTAL  
DECISION OF THE NATIONAL LABOR RELATIONS BOARD*

---

**BRIEF FOR THE NATIONAL LABOR RELATIONS BOARD**

---

## **JURISDICTION**

This case is before the Court upon petition of the Great Western Broadcasting Corporation, d/b/a KXTV, hereafter called KXTV, to review a supplemental decision of the National Labor Relations Board issued December 16, 1964, dismissing an unfair labor practice complaint (R. 19-27)<sup>1</sup> which had issued upon charges filed by KXTV. The Board's original decision

---

<sup>1</sup> The printed record in No. 17,698, the prior appeal in this matter, has, by stipulation of the parties, been made a part of the record here. References to that record are designated "R." The Board's Supplemental Decision, entered after this Court's remand, is reprinted in Appendix B, *infra*, pp. 25-34.

and order (R. 65-76) are reported at 134 NLRB 1617. This Court's opinion, setting aside that order and remanding the case to the Board, is reported at 310 F. 2d 591. The Board's supplemental decision on remand (*infra*, pp. 25-34), is reported at 150 NLRB No. 46. This Court has jurisdiction of the proceeding under Section 10(f) of the National Labor Relations Act, the alleged unfair labor practices having occurred within this judicial circuit.<sup>2</sup>

#### COUNTERSTATEMENT OF THE CASE

##### I. The earlier Board and Court decisions

The complaint alleged that the Unions,<sup>3</sup> in furtherance of a strike against KXTV, engaged in conduct which was violative of Section 8(b)(4)(ii)(B) of the Act (*infra*, p. 5). As detailed more fully in the Court's first decision (310 F. 2d at 593-594), the Unions: (1) made oral appeals to advertisers who used KXTV to discontinue their patronage of the station; (2) sent letters to advertisers advising them of the background of the strike and warning them of adverse economic reaction if they continued to use the station; (3) printed and distributed 4,000 handbills listing KXTV as "unfair" and naming Greer, Rainbo, Shell, and Burgermeister<sup>4</sup> as advertisers who continued to utilize KXTV, which handbills were dis-

<sup>2</sup> The pertinent statutory provisions are reprinted in Appendix A, *infra*, pp. 23-24.

<sup>3</sup> American Federation of Television and Radio Artists, San Francisco Local and The National Association of Broadcast Employees and Technicians, Local 55.

<sup>4</sup> An automobile dealer, a baking company, a gasoline service chain, and a beer manufacturer and distributor.

tributed in front of KXTV, at the Sacramento Labor Temple, and at various grocery stores which handled Rainbo bread and Burgermeister beer; (4) sent letters to the San Francisco Labor Council asking it and the members of its affiliated unions to turn in their Shell credit cards, and listing 14 companies who were then advertising on KXTV and soliciting "any aid" the Council and the members of its affiliates "can give"; and (5) threatened two advertisers with being named in a new leaflet unless they discontinued using KXTV. The Board held that the Unions' conduct was protected by the "publicity proviso" to Section 8(b)(4) (*infra*, p. 5), which removes from the ban of that section "publicity, other than picketing, for the purpose of truthfully advising the public including consumers and members of labor organizations, that a product or products are produced by an employer with whom the labor organization has a primary dispute and are distributed by another employer. \* \* \*" The Board accordingly dismissed the complaint. (R. 65-76.)

On KXTV's petition to review, this Court reversed the Board, holding that the television advertising services of KXTV were not "a product or products" within the meaning of the proviso to Section 8(b)(4). Although recognizing that those terms were capable of being construed to encompass the rendition of services, the Court concluded that the context in which they appeared indicated that Congress intended to give them a more restrictive meaning. That is, the Court was of the view that, in the proviso, Congress was

referring only to the manufacturer or processor of a tangible article. (310 F. 2d at 595-598.)

However, the Unions, which had been permitted to intervene, argued that, in any event, their conduct did not constitute threats, coercion, or restraint within the meaning of Section 8(b)(4)(ii)(B) and that such conduct was indeed protected by the First Amendment. The Court remanded the case to the Board to consider these questions. (310 F. 2d at 600.)

## II. The supplemental Board decision

The Board, evaluating each of the actions engaged in by the Unions, found that all of the conduct, other than the mere request that neutrals not advertise on KXTV, constituted threats, coercion, or restraint within the meaning of Section 8(b)(4)(ii)(B) of the Act (*infra*, p. 5). However, the Board again dismissed the complaint on the ground that the Unions' conduct was protected under the publicity proviso to Section 8(b)(4).<sup>5</sup> The Board concluded that, in *N.L.R.B. v. Servette, Inc.*, 377 U.S. 46, 54-57 (discussed more fully, *infra*, pp. 8-10), which was decided after the remand here, the Supreme Court had rejected this Court's narrow interpretation, and had confirmed the Board's broader reading, of the proviso.<sup>6</sup> (*Infra*, pp. 31-33.)

<sup>5</sup> In view of its dismissal of the complaint, the Board found it unnecessary to, and thus did not reach, the question whether Section 8(b)(4)(ii)(B) would be constitutional if it were construed to cover the conduct here (*infra*, p. 33).

<sup>6</sup> The Supreme Court reversed this Court's decision in *Servette, Inc. v. N.L.R.B.*, 310 F. 2d 659, 667. There, this Court, applying its holding in the instant case, had held that the proviso did not protect handbilling of secondary employers in furtherance of a dispute with a distributor.

## ARGUMENT

**The Unions' activity was protected by the publicity proviso to Section 8(b)(4)****A. The Supreme Court decisions in *Servette* and *Fruit and Vegetable Packers***

Section 8(b)(4)(ii)(B) of the Act makes it an unfair labor practice for a union—

to threaten, coerce, or restrain any person \* \* \* where an object thereof is—

forcing or requiring any person to cease using, selling, handling, transporting or otherwise dealing in the products of any other producer, processor, or manufacturer, or to cease doing business with any other person. \* \* \*

A proviso to Section 8(b)(4) adds—

That for the purposes of this paragraph (4) only, nothing contained in such paragraph shall be construed to prohibit publicity, other than picketing, for the purpose of truthfully advising the public, including consumers and members of a labor organization, that a product or products are produced by an employer with whom the labor organization has a primary dispute and are distributed by another employer, as long as such publicity does not have an effect of inducing any individual employed by any person other than the primary employer in the course of his employment to refuse to pick up, deliver, or transport any goods, or not to perform any services, at the establishment of the employer engaged in such distribution.

The Supreme Court, in *N.L.R.B. v. Servette, Inc.*, 377 U.S. 46, and *N.L.R.B. v. Fruit and Vegetable Packers, Local 760*, 377 U.S. 58, laid down the prin-



ciples for applying these provisions. In *Fruit and Vegetable Packers*, the union, in furtherance of a dispute with some fruit packers, picketed retail stores with signs requesting the consuming public not to purchase apples obtained from those packers. The Board, finding that the picketing tended to threaten or restrain the neutral stores, for an object of forcing them to cease doing business with the disfavored packers, held that the picketing violated Section 8(b)(4)(ii)(B) of the Act. The Supreme Court set aside the Board's order.

The Court, being of the view that a ban on all peaceful consumer picketing at secondary sites would raise a serious constitutional question, examined the legislative history of the 1959 amendments to Section 8(b)(4) with great care and concluded that it merely reflected a congressional intention to proscribe such picketing where it was designed "to persuade the customers of the secondary employer to cease trading with him," and not where it was "directed only at the struck product" (377 U.S. at 63). As the Court explained (*id.*, at 63-64):

In the latter case, the union's appeal to the public is confined to its dispute with the primary employer, since the public is not asked to withhold its patronage from the secondary employer, but only to boycott the primary employer's goods. On the other hand, a union

appeal to the public at the secondary site not to trade at all with the secondary employer goes beyond the goods of the primary employer, and seeks the public's assistance in forcing the secondary employer to cooperate with the union in its primary dispute. \* \* \* <sup>7</sup>

Nor, in the Court's view, was a congressional intention to proscribe all consumer picketing at secondary sites shown by the circumstance that the proviso to Section 8(b)(4) privileged "publicity, other than picketing," but made no allowance for picketing confined to the product in dispute. The Court stated (377 U.S. at 70-71):

The proviso indicates no more than that the Senate conferees' constitutional doubts led Congress to authorize publicity other than picketing which persuades the customers of a second-

---

<sup>7</sup> The Court added (377 U.S. at 72):

When consumer picketing is employed only to persuade customers not to buy the struck product, the union's appeal is closely confined to the primary dispute. The site of the appeal is expanded to include the premises of the secondary employer, but if the appeal succeeds, the secondary employers' purchases from the struck firms are decreased only because the public has diminished its purchases of the struck product. On the other hand, when consumer picketing is employed to persuade customers not to trade at all with the secondary employer, the latter stops buying the struck product, not because of a falling demand, but in response to pressure designed to inflict injury on his business generally. In such case, the union does more than merely follow the struck product; it creates a separate dispute with the secondary employer. [Footnote omitted.]

any employer to stop all trading with him, but not such publicity which has the effect of cutting off his deliveries or inducing his employees to cease work. On the other hand, picketing which persuades the customers of a secondary employer to stop all trading with him was also to be barred.

In *Servette*, the union, in furtherance of its dispute with a wholesale distributor of specialty merchandise, requested the managers of certain food chains to discontinue handling goods supplied by Servette. The managers were warned that handbills asking the public not to buy the items distributed by Servette would be passed out in front of stores which refused to cooperate, and in some cases handbills were in fact passed out. The Supreme Court, reversing this Court's decision (see n. 6, *supra*), sustained the Board's dismissal of the unfair labor practice complaint. The Court held that the requests to the store managers were not barred by subparagraph (i) of Section 8(b)(4), for that provision merely interdicted the inducement of employees to withhold employment services and not the inducement of managerial personnel to make a management decision.<sup>8</sup> 377 U.S. at 49-54. The Court further held that the handbilling, and the threats to handbill, did not constitute threats, coercion, or restraint barred by subparagraph (ii) of

---

<sup>8</sup> Subparagraph (i) makes it an unfair labor practice for a labor organization "to induce or encourage any individual employed by any person \* \* \* to engage in, a strike or a refusal in the course of his employment to use, manufacture, process, transport, or otherwise handle or work on any goods, articles, materials, or commodities or to perform any services"—for the proscribed secondary object.

Section 8(b)(4), for such activity was protected by the publicity proviso. Rejecting this Court's view that the proviso was inapplicable because the union's dispute was with a wholesaler, and not the manufacturer, the Supreme Court stated (377 U.S. at 55):

The proviso was the outgrowth of a profound Senate concern that the unions' freedom to appeal to the public for support of their case be adequately safeguarded. \* \* \* It would fall far short of achieving this basic purpose if the proviso applied only in situations where the union's labor dispute is with the manufacturer or processor. \* \* \* There is nothing in the legislative history which suggests that the protection of the proviso was intended to be any narrower in coverage than the prohibition to which it is an exception, and we see no basis for attributing such an incongruous purpose to Congress.

In sum, the Supreme Court decisions in *Fruit and Vegetable Packers* and *Servette* hold that Congress moved with extreme caution and drew careful lines in interdicting union appeals to the consuming public to aid it in its dispute with a primary employer. That is, even though such appeals occur at a secondary site and thus may tend, in a very real sense, to exert economic pressure on neutral employers to cease doing business with the primary employer, not all such appeals fall within the ban of Section 8(b)(4)(ii)(B). First, a distinction must be drawn between appeals to consumers which merely call for a boycott of the primary employer's goods, and those which call for a more widespread boycott. The former type of boycott

appeals, whether made by picketing or by other means, do not constitute a threat, coercion, or restraint within the meaning of subparagraph (ii) of Section 8(b)(4). Second, with respect to consumer boycott appeals which are not limited to the primary employer's goods, a distinction must be drawn between appeals made by means of picketing and those which are made by other means, such as oral requests and handbilling. Such "broad" appeals constitute a threat, coercion, or restraint within the meaning of subparagraph (ii) of Section 8(b)(4), and, if made by picketing, the picketing would be unlawful (assuming the secondary object proscribed in (B) is found); however, if "publicity" other than picketing be used, the activity is saved from the ban of Section 8(b)(4)(ii)(B) by the publicity proviso to that section (absent an interference with deliveries).

**B. Under the foregoing principles, the Unions' activity here, although constituting threats, coercion, or restraint within the meaning of Section 8(b)(4)(ii), was saved by the publicity proviso**

1. With one exception,<sup>9</sup> the conduct engaged in by the Unions falls into three general categories: (a) calls upon advertisers, requesting that they discontinue advertising on KXTV and warning, that if they did not, appeals would be made to consumers not to

---

<sup>9</sup> The conduct listed in item (1) in the Court's prior opinion (310 F. 2d at 593) consisted of requests that advertisers cease doing business with KXTV. Since the requests were unaccompanied by threats of subsequent economic action, the Board properly found that they were not within the reach of Section 8(b)(4)(B). See *N.L.R.B. v. Servette*, 377 U.S. at 54, and n. 12. Petitioner, although disagreeing with this conclusion, does not contest it now (Br. 7, n. 11).



buy their products (items 2, 3, 7, and 8 in the Court's prior opinion, 310 F. 2d at 593-594); (b) letters to the Labor Council requesting it and its members not to patronize the "non-cooperative" advertisers, and to turn in their credit cards for one such advertiser (items 5 and 6); (c) distribution of handbills listing KXTV and its advertisers and requesting the public not to buy the advertisers' products (item 4). The Board found that this conduct was "part of a campaign calculated to bring economic pressure upon the producers and distributors of products advertised on KXTV for the purpose of forcing the producers to cease advertising on KXTV" (*infra*, p. 28). That is, the advertisers (who were neutral secondary employers) were threatened with a loss of consumer patronage if they did not discontinue advertising on KXTV.

Nor was the appeal limited to a boycott of "the primary employer's goods," as in *Fruit & Vegetable Packers, supra*. As the Board stated (*infra*, p. 31), whether those goods "be viewed as the physical product advertised over the facilities of KXTV, or as merely the advertising component added to the product by KXTV's efforts," it is clear that the Union's appeals and related conduct were not so limited. Obviously, their activities could not, and were not, confined to a boycott of only the advertising component. Moreover, the Unions did not confine their appeal to the particular products advertised on KXTV, but rather, as the Board found, sought "the institution of a consumer boycott of all products distributed by the



companies it listed as advertising on KXTV" (*infra*, p. 30).<sup>10</sup>

Accordingly, the Board properly concluded that the conduct in the three categories described above constituted threats, coercion, or restraint for a secondary object, and hence would have violated Section 8(b)(4)(ii)(B) but for the publicity proviso, which we now discuss.

2. Respecting the proviso to Section 8(b)(4) (*supra*, p. 5), the calls, letters and handbills described above were "publicity, other than picketing"; and they were made or circulated "for the purpose of truthfully advising the public, including consumers and members of a labor organization," of the Unions' dispute with KXTV and of enlisting their aid. The proviso, however, further speaks of advising the public, "that a product or products are produced by an employer with whom the labor organization has a primary dispute and are distributed by another employer"; and the question is whether a television station, like KXTV, in performing an advertising service, can be deemed to be the "producer" of a "product or products."

---

<sup>10</sup> Thus, the letter sent to all advertisers warned that as a result of the Union's coming publicity campaign there would be resentment against "any product *or sponsor*" who takes sides by advertising on KXTV (R. 98, emphasis supplied). The handbills distributed to the public did not specify which products were advertised on KXTV, but merely listed companies who were continuing to advertise and thereby made it appear that a boycott of the total business of these companies was sought (R. 100-101). And, the request to the San Francisco Labor Council that it and the members of its affiliated unions return the credit cards of Shell was not limited to the particular Shell products advertised on KXTV.

In its first decision, the Board, following its ruling in *Lohman Sales Co.*, 132 NLRB 901, 906-908, that the proviso encompassed anyone who enhanced the economic value of the product ultimately sold or consumed, held that KXTV was the "producer" of a "product or products."<sup>11</sup> But, this Court rejected the Board's holding. Although it recognized that the terms "product" and "produced" were susceptible of the interpretation given them by the Board (see 310 F. 2d at 595, 597), it concluded that the context in which the words appeared made it clear that Congress meant to encompass only the manufacturer or processor of a tangible product.<sup>12</sup>

We submit that the Supreme Court decisions in *Fruit & Vegetable Packers* and *Servette* (*supra*, pp. 5-10) have undermined the premise for this Court's

---

<sup>11</sup> In *Lohman*, as in *Servette*, *supra*, the union's primary dispute was with the distributor of physical products. However, the principle enunciated there was broad enough to encompass one who merely performed services, and in *Middle South Broadcasting Co.*, 133 NLRB 1698, 1704-1706, the Board had specifically applied *Lohman* to a situation where, as here, the primary dispute was with a radio station.

<sup>12</sup> Thus, the Court pointed out that the proviso speaks of "product or products" that are "produced" by the primary employer and "distributed by another employer"; advertising was incapable of being "distributed" particularly where the subject being advertised was not a physical product but a service itself (310 F. 2d at 597-598). And, the Court noted that Congress, in subparagraph (B) of Section 8(b)(4), had used the words "the products of any other producer, processor, or manufacturer," and concluded that it must have intended to use the comparable terms in the proviso in the same sense (*id.*, at 598). In addition, the Court noted that an earlier version of the proviso, with broader language, had not been adopted by Congress (*id.*, at 600).

narrow interpretation of the proviso, and have confirmed the Board's broader reading thereof. Thus, in *Servette*, the Supreme Court, noting that this Court had followed its decision in the instant case and the Board had followed its ruling in *Lohman, supra*, stated, "We agree with the Board" (377 U.S. at 55). In support of this conclusion, the Supreme Court, in the passage quoted earlier (p. 9), pointed out that the "proviso was the outgrowth of a profound Senate concern that the unions' freedom to appeal to the public for support of their case be adequately safeguarded"; and that it "would fall far short of achieving this basic purpose if the proviso applied only in situations where the union's labor dispute is with the manufacturer or processor." It added (377 U.S. at 55, and *supra*, p. 9):

There is nothing in the legislative history which suggests that the protection of the proviso was intended to be any narrower in coverage than the prohibition to which it is an exception, and we see no basis for attributing such an incongruous purpose to Congress.

Finally, recognizing that this Court's restrictive reading of "producer" was prompted in part by the language of Section 8(b)(4)(B) (see n. 12, *supra*), the Supreme Court concluded that "producer" had to be given a broader reach for purposes of the proviso, or "else it is rendered virtually superfluous" (377 U.S. at 56).<sup>13</sup>

---

<sup>13</sup> The Supreme Court also attached no significance to the fact that another version of the proviso had broader language (see n. 12, *supra*), pointing out that: "This version was in a request

Subsequent to the Supreme Court's decision in *Servette*, this Court, in holding that the term "products of any employer" in Section 8(e) included "services furnished by an employer performing a distribution function," acknowledged that its earlier interpretation of the analogous terms in the proviso to Section 8(b)(4) had been too restrictive. *N.L.R.B. v. Joint Council of Teamsters*, 338 F. 2d 23, 26 (C.A. 9). The Court stated: "We recognized in *Great Western Broadcasting Corp. v. Labor Board*, 310 F. 2d 591, 595 (9th Cir. 1962), that the term 'product' may be construed to encompass services rendered, but thought (erroneously, as the Supreme Court held in *Servette*) that the context of § 8(b)(4) of the Act required a narrower reading" (*id.*, at 26, n. 3).

Although the primary employer in *Servette* was the distributor of a tangible product whereas here he renders an intangible service, the rationale of the Supreme Court's decision encompasses the latter situation no less than the former. The basic principle of the Court's holding is that Congress intended that the protection of the proviso not "be any narrower in coverage than the prohibition to which it is an exception." Where a means other than "publicity" is used, the prohibitory portion of Section 8(b)(4)(B) clearly reaches secondary activity in furtherance of a primary dispute with a radio station or other supplier of

---

by the Senate conferees for instructions but was not made the subject of debate or vote because Senate and House conferees reached agreement on the proviso" (377 U.S. at 56, n. 15).

services,<sup>14</sup> no less than one in furtherance of a primary dispute with a distributor of a tangible product. Accordingly, it would follow that, where the means specified in the proviso are utilized, the proviso privileges the secondary activity irrespective of the function performed by the primary employer.<sup>15</sup>

Petitioner contends (Br. 9-11), however, that, to construe the proviso as applying to a situation where, as here, the primary employer supplies only an intangible service, would enlarge the exemption from the secondary boycott provisions to such an extent that it cannot reasonably be assumed that Congress intended to do so. Thus, petitioner argues, if the proviso is confined to situations where the primary employer processes or handles a tangible product, the union would only be able to "follow forward," from

---

<sup>14</sup> See, e.g., *N.L.R.B. v. Associated Musicians (Gotham Broadcasting Co.)*, 226 F. 2d 900 (C.A. 2), cert. denied, 351 U.S. 962; *Teamsters, Local 901 ("Editorial Imparcial")*, 134 NLRB 895, 901, 10(1) injunction sustained on appeal, *Local 901, Teamsters v. Compton*, 291 F. 2d 793 (C.A. 1); *Local Union 154, Int'l Typographical Union (Ypsilanti Press)*, 135 NLRB 991, 996. See also *Hoffman v. Typographical Local 37*, 59 LRRM 2983 (D. Hawaii).

<sup>15</sup> Petitioner characterizes the Supreme Court's statement that the proviso should not be any narrower than the prohibitory part of Section 8(b)(4)(B) as "dictum" (Br. 14). We submit that a reading of the Court's opinion as a whole shows that, on the contrary, the statement is an integral part of the Court's analysis. Moreover, although the Court made the statement after pointing out that the activities of the Teamsters Union were a prime consideration in enacting Section 8(b)(4)(B) and the proviso, there is no warrant for assuming, as petitioner does, that the Court was, at most, only referring to the situations involving that union, which would usually entail following a tangible product.



the point of the dispute to the point where the products are being distributed. But, petitioner adds, if the proviso applies to situations where the primary employer is a newspaper or a broadcasting station, the union would be permitted to "go backwards" as well; i.e., it would be able to request consumers to boycott not only the "product" actually "produced" by the primary employer (newspapers, and radio and television programs), but also the "products" of the latter's advertisers. There is no merit to this contention.

First, there is no basis for petitioner's assumption (Br. 10) that, in a *Servette* situation, where the union's dispute is with a wholesaler of tangible products, the proviso permits the union to appeal for consumer support only at the retail stores handling the goods supplied by the wholesaler, and not also at the premises of the manufacturer who first processed the goods. If the union were to use a means other than "publicity" to exert consumer pressure against the neutral manufacturer, its action would be barred by the prohibitory part of Section 8(b)(4)(B); if the exemption of the proviso is to be coextensive with the prohibition, it would follow that "publicity" exerted against the manufacturer is exempt, no less than that exerted against neutrals at the other end, the retail stores. Indeed, one of the principal justifications for this Court's earlier decision—which confined the publicity proviso to a situation where the primary dispute was with a manufacturer or processor of a tangible product—was that it insured that the union could only move "forward" from the point of the dispute and



not "go backward" as well; but this consideration was rendered immaterial when the Supreme Court, in *Servette*, held that the proviso also applied to a situation where the primary dispute was with a wholesaler.

Second, to conclude that the proviso only applies where a tangible product is involved is to discriminate against various industries; that is, unions involved in disputes with processors and distributors of physical products would have an exemption from the secondary boycott provisions of the Act, when they appealed to consumers by means of "publicity, other than picketing," which unions involved in disputes with employers in service industries would not have. Since, as shown, the prohibitory part of Section 8(b)(4)(B) applies to persons who perform services as well as to processors and distributors of physical products, such a result would be contrary to the congressional objective of making the proviso coextensive with the prohibitory part of the section. Moreover, a distinction between tangible products and services could only be justified on the ground that the pressure on the neutral can be minimized in the former case but not in the latter. Thus, with a tangible product, consumers can be requested merely to boycott that product; but, where services are involved, the union has to call for a boycott of the entire business receiving that service.<sup>16</sup> However, the Supreme Court has ruled

---

<sup>16</sup> For example, if the union has a dispute with a manufacturer or distributor of "X" bread, it can request consumers, at retail stores handling it, not to buy that bread. On the other hand, if the union has a dispute with the company furnishing refrigeration service to the retail stores, it can only request consumers not to patronize the stores. Similarly here, where

that, while this consideration may be relevant insofar as picketing is concerned, it is irrelevant with respect to "publicity, other than picketing." As pointed out (*supra*, pp. 7-8), the Court, in *Fruit and Vegetable Packers*, held that, while Section 8(b)(4)(ii)(B) bars "picketing which persuades the customers of a secondary employer to stop all trading with him," the function of the proviso is "to authorize publicity other than picketing" even though it stopped "all trading with" the secondary employer.

In sum, in the light of the considerations set forth by the Supreme Court in *Servette* and *Fruit and Vegetable Packers*, *supra*, there is no warrant for denying the protection of the Section 8(b)(4) publicity proviso to service industries or in making that protection turn on whether the union is following the dispute "forward" or "backward."<sup>17</sup> The Board

---

the dispute was with a television station advertising various products and services, the Unions could not confine their consumer appeal to the service performed by KXTV but had to call for a consumer boycott which was more widespread (see *supra*, pp. 11-12).

<sup>17</sup> Petitioner notes (Br. 13) that the Supreme Court, in *Servette*, buttressed its conclusion that the term "produced" in the proviso to Section 8(b)(4) covered a wholesaler of tangible products by reference to decisions under the Fair Labor Standards Act. While the meaning given to the terms used in that earlier and different statute does not necessarily reflect Congress' objective in enacting the 1959 proviso to the NLRA, it is significant that employees engaged in a wide variety of service operations have been held to be engaged in work necessary to the production of goods for commerce, within the meaning of Section 203(j) of the FLSA (29 U.S.C. § 203(j)). See, e.g., *Kirschbaum v. Walling*, 316 U.S. 517 (employees engaged in maintenance of loft buildings, the tenants of which were en-

therefore properly concluded that the proviso privileged the Unions' activity here.<sup>18</sup>

**C. The "law of the case" doctrine is inapplicable**

Finally, there is no substance to petitioner's contention (Br. 15-16) that the doctrine of "law of the case" precludes the Board, at this time, from contesting this Court's earlier ruling that the Unions' activity was not privileged by the proviso to Section 8(b)(4). It is well settled that a departure from that doctrine is justified where, as here, an intervening Supreme Court decision establishes that the intermediate appellate tribunal, in remanding the case at bar, has applied an erroneous rule of law. *Simmons Co. v. Grier Bros. Co.*, 258 U.S. 82, 91; *City of Seattle v. Puget Sound Power & Light Co.*, 15 F. 2d 794, 795

gaged in the production of goods for commerce); *Bozant v. Bank of New York*, 156 F. 2d 787 (C.A. 2) (maintenance employees in bank building); *Union National Bank of Little Rock v. Durkin*, 207 F. 2d 848 (C.A. 8) (maintenance employees in bank building); *Goldstein v. Dabanian*, 291 F. 2d 208 (C.A. 3) (employees of check cashing service); *Public Bldg. Authority of Birmingham v. Goldberg*, 298 F. 2d 367 (C.A. 5) (maintenance employees employed by a private contractor managing a building housing federal employees engaged in processing social security claims from a multi-state area and in disbursing checks based on those claims); *Mitchell v. Dooley Bros., Inc.*, 286 F. 2d 40 (C.A. 1) (employees of independent contractor providing cleaning services to businesses engaged in commerce or in the production of goods for commerce).

<sup>18</sup>The decision in *Columbia Broadcasting System, Inc. v. Amana Refrigeration, Inc.*, 295 F. 2d 375 (C.A. 7), certiorari denied, 369 U.S. 812 (Pet. 15), is inapposite. That case, which was decided before the Supreme Court decision in *Servette, supra*, involved an interpretation of Sections 2(a) and 3 of the Clayton Act, provisions which did not have the same history as, and were intended to serve a different purpose than, the proviso to Section 8(b)(4) of the NLRA.

(C.A. 9); *Pacific American Fisheries v. Hoof*, 291 Fed. 306, 309 (C.A. 9); *Zdanok v. Glidden*, 327 F. 2d 944, 951 (C.A. 2) cert. den., 377 U.S. 934; *Lumminous Unit Co. v. Freeman Sweet Co.*, 3 F. 2d 577, 580 (C.A. 7); *Maryland Casualty Co. v. City of South Norfolk, et al.*, 54 F. 2d 1032, 1039 (C.A. 4); *Commissioner of Internal Revenue v. Netcher*, 143 F. 2d 484, 486 (C.A. 7); *White v. Higgins*, 116 F. 2d 312, 317 (C.A. 1); *Higgins, et al. v. California Prune & Apricot Growers, Inc.*, 3 F. 2d 896, 898 (C.A. 2); Note, *Law of the Case*, 5 Stanford L. Rev. 751, 765; 1B Moore, *Federal Practice* (2d ed. 1965) Sec. 0.404[10] at p. 575. Moreover, since a Board remedial order would have *in futuro* effect and it is also well settled that an injunction may be modified in the light of subsequent changes in the law,<sup>13</sup> application of the law of the case doctrine would only result in a futile act; i.e., it would compel the issuance of a cease and desist order which would then be subject to vacation because of the Supreme Court decisions in *Servette* and *Fruit and Vegetable Packers, supra*.

---

<sup>13</sup> See *Pennsylvania v. Wheeling & Belmont Bridge Co.*, 18 How. (59 U.S.) 421, 431-432; *System Federation No. 91 v. Wright*, 364 U.S. 642.

## CONCLUSION

For the reasons stated, it is respectfully submitted that the supplemental petition to review should be denied.

ARNOLD ORDMAN,  
*General Counsel,*

DOMINICK L. MANOLI,  
*Associate General Counsel,*

MARCEL MALLET-PREVOST,  
*Assistant General Counsel,*

NORTON J. COME,  
*Assistant General Counsel,*

MICHAEL N. SOHN,  
*Attorney,*  
*National Labor Relations Board.*

SEPTEMBER 1965.

## CERTIFICATE

The undersigned certifies that he has examined the provisions of Rules 18 and 19 of this Court, and in his opinion the tendered brief conforms to all requirements.

MARCEL MALLET-PREVOST,  
*Assistant General Counsel,*  
*National Labor Relations Board.*



## APPENDIX A

The relevant provisions of the National Labor Relations Act, as amended (61 Stat. 136, 73 Stat. 519, 29 U.S.C. Secs. 151, *et seq.*) are as follows:

(4)(i) to engage in, or to induce or encourage any individual employed by any person engaged in commerce or in an industry affecting commerce to engage in, a strike or a refusal in the course of his employment to use, manufacture, process, transport, or otherwise handle or work on any goods, articles, materials, or commodities or to perform any services; or (ii) to threaten, coerce, or restrain any person engaged in commerce or in an industry affecting commerce, where in either case an object thereof is: \* \* \*

(B) forcing or requiring any person to cease using, selling, handling, transporting, or otherwise dealing in the products of any other producer, processor, or manufacturer, or to cease doing business with any other person, or forcing or requiring any other employer to recognize or bargain with a labor organization as the representative of his employees unless such labor organization has been certified as the representative of such employees under the provisions of section 9: \* \* \*

*Provided further,* That for the purposes of this paragraph (4) only, nothing contained in such paragraph shall be construed to prohibit publicity, other than picketing, for the purpose of truthfully advising the public, including consumers and members of a labor organization, that a product or products are produced by an employer with whom the labor organization has a primary dispute and are distributed by



another employer, as long as such publicity does not have an effect of inducing any individual employed by any person other than the primary employer in the course of his employment to refuse to pick up, deliver, or transport any goods, or not to perform any services, at the establishment of the employer engaged in such distribution;

## APPENDIX B

UNITED STATES OF AMERICA, BEFORE THE NATIONAL  
LABOR RELATIONS BOARD

Case No. 20-CC-234

AMERICAN FEDERATION OF TELEVISION AND RADIO  
ARTISTS, SAN FRANCISCO LOCAL; NATIONAL ASSOCIA-  
TION OF BROADCAST EMPLOYEES AND TECHNICIANS,  
LOCAL 55

and

GREAT WESTERN BROADCASTING CORPORATION  
d/b/a KXTV

### SUPPLEMENTAL DECISION

On December 27, 1961, the Board issued a Decision and Order in the instant case<sup>1</sup> finding that the Respondent Unions had not violated Section 8(b) (4)(ii)(B) of the Act as alleged. The Board held, in substance, that Respondents' conduct was protected by the so-called "publicity proviso" to that section.

Thereafter, the Charging Party filed a petition to review the Board's Order. On November 9, 1962, the Court of Appeals for the Ninth Circuit reversed the Board,<sup>2</sup> holding that the television advertising services of the primary employer, television station KXTV, were not "a product or products" within the meaning of that term in the proviso to Section 8(b) (4). The Court remanded the case to the Board for

---

<sup>1</sup> 134 NLRB 1617.

<sup>2</sup> *Great Western Broadcasting Corporation v. N.L.R.B., et al.*, 310 F. 2d 591 (C.A. 9).

consideration of two issues which were not reached by the Board in its original decision.<sup>3</sup>

Pursuant to the provisions of Section 3(b) of the National Labor Relations Act, the Board has delegated its powers in connection with this case to a three-member panel.

The first issue set forth in the remand is:

Whether the conduct engaged in by the Respondents constituted threats, coercion or restraint within the meaning of Section 8(b)(4)(ii)(B) of the Act.<sup>4</sup>

<sup>3</sup> On February 8, 1963, the Charging Parties' motion to remand for the taking of additional evidence was denied by the Board and the American Civil Liberties Union was granted leave to file an amicus curiae brief.

<sup>4</sup> Section 8(b)(4)(ii)(B) provides, in pertinent part, as follows:

"It shall be an unfair labor practice for a labor organization or its agents—

"(ii) to threaten, coerce, or restrain any person engaged in commerce or in an industry affecting commerce, where \* \* \* an object thereof is:

\* \* \* \* \*

"(B) forcing or requiring any person to cease using, selling, handling, transporting, or otherwise dealing in the products of any other producer, processor, or manufacturer, or to cease doing business with any other person—

\* \* \* \* \*

"Provided further, That for the purposes of this paragraph (4) only, nothing contained in such paragraph shall be construed to prohibit publicity, other than picketing, for the purpose of truthfully advising the public, including consumers and members of a labor organization, that a product or products are produced by an employer with whom the labor organization has a primary dispute and are distributed by another employer, as long as such publicity does not have an effect of inducing any individual employed by any person other than the primary employer in the course of his employment to refuse to pick up, deliver, or transport any goods, or not to perform any services, at the establishment of the employer engaged in such distribution;"

\* \* \* \* \*

In setting forth the conduct which it wished the Board to evaluate, the Court pointed out that Respondents:

(1) had committees of the unions call upon all advertisers who used KXTV for the purpose of requesting them to discontinue their patronage of the station and assist the unions in their cause against KXTV;

(2) had a committee call upon Capitol Studebaker Company for the same purpose, in the course of which this advertiser was told that if it continued to advertise on KXTV the Labor Council would undoubtedly print the name of Capitol in the Labor Bulletin as not supporting the strike;

(3) mailed to all KXTV advertisers a letter setting forth the background of the strike and requesting discontinuance of advertising over the station, warning that failure to do so would bring an adverse economic reaction;

(4) printed and distributed four thousand handbills listing KXTV as "unfair," and naming Geer Chevrolet Company, Rainbo Baking Company, Shell Oil Company and Burgermeister Brewing Corporation as advertisers who nevertheless continued to utilize the services of the station, such distribution being made in front of KXTV, at the Sacramento Labor Temple, and at various Sacramento grocery stores which handled Rainbo bread and Burgermeister beer;<sup>5</sup>

(5) sent a letter to the San Francisco Labor Council asking the Council to return its Shell credit

---

<sup>5</sup> Copies of this leaflet were also found stuffed between loaves of bread at a supermarket supplied by Rainbo. The leaflet carried this note:

"This statement is directed to customers of the above advertisers. It is not a request to employees to refuse to pick up, deliver or transport, or to refuse to perform any service."

card to that company and to request the members of affiliated unions to do likewise;

(6) sent a later letter to the San Francisco Labor Council listing 14 companies who were then advertising on station KXTV, with the observation that "any aid" the Council and its affiliated members "can give in this sponsor area" would be appreciated;

(7) showed to the President of Handy-Andy, with an appeal to stop advertising on KXTV, a copy of the newly-printed leaflet which gave the background of the labor dispute with KXTV, named Handy-Andy as a company which continued to do business with KXTV, and added the comment: "We think you will agree that this continued association is contrary to the best interests of working people and the public";

(8) telephoned the general manager of Geer and, in conjunction with an appeal to have Geer cease advertising on KXTV, informed him that a new leaflet was being printed naming Geer as a sponsor still advertising on KXTV and that if Geer continued to do business with the station, this leaflet would be passed out in front of Geer's establishment, among other places.

The Board has reviewed the eight items of conduct enumerated in the Court of Appeals remand. We find that Item 1, a mere request to neutral employers unaccompanied by any coercive acts, did not involve prohibited activity within the meaning of Section 8(b)(4)(ii)(B).<sup>6</sup> However, with respect to the other seven items, we find that the acts were part of a campaign calculated to bring economic pressure upon the producers and distributors of products advertised on KXTV for the purpose of forcing the producers to cease advertising on KXTV. The acts complained of

---

<sup>6</sup> See *N.L.R.B. v. Servette, Inc.*, 377 U.S. 46, 50-54.



may be characterized as threats to distribute, and the actual distribution of, leaflets and letters<sup>7</sup> announcing that the named companies were continuing to advertise on KXTV, and appealing to consumers to support Respondent in its dispute with KXTV. The Respondent made no attempt to limit consumer response to a boycott of only the particular product or products advertised, and it is plain from a reading of the leaflets and letters, and from the threats made to advertisers that Respondent's object was the institution of a total boycott of all products produced by companies advertising on KXTV. With respect to Handy Andy, Geer Chevrolet, and Capital Studebaker, and Shell Oil Company, Respondent sought a total boycott of their retail establishments. With respect to Rainbo Baking Company, and Burgemeister Brewery, Respondent appealed to consumers to refrain from buying any of their products sold in retail establishments without regard to whether the particular product was advertised on KXTV.

Other than its dispute with KXTV, Respondent had no dispute with any producer or distributor of products advertised on KXTV, and the question presented is whether Respondent's activities described above, constitute restraint or coercion within the

---

<sup>7</sup> In making our findings with respect to item No. 5 (request to the San Francisco Labor Council to return Shell credit cards) we note, as stated in our original opinion, 134 NLRB 1617, 1618, that as a result of this request Shell received numerous letters enclosing Shell credit cards. We further note that as a result of item No. 6 (letter to the San Francisco Council observing that "any aid" from the Council would be appreciated) a synopsis of the Labor Council minutes of the meeting of January 6, 1961, was mailed to everyone on the mailing list, including member unions and individual members, in which it was requested that the recipients discontinue purchases of the products or use of the services of specified companies who were still advertising on KXTV.



meaning of Section 8(b)(4)(ii) of the Act. The Supreme Court has held that picketing appeals to customers of a large retailer, which were limited to requesting customers to refrain from purchasing the particular product of the primary employer with whom the Union had a primary dispute, did not constitute coercion as defined in this Section of the Act.<sup>8</sup> The Court drew a distinction in this regard between consumer picketing in support of a product boycott and consumer picketing which sought to enforce a total boycott of the neutral employer's premises:

When consumer picketing is employed only to persuade customers not to buy the struck product, the union's appeal is closely confined to the primary dispute. The site of the appeal is expanded to include the premises of the secondary employer, but if the appeal succeeds, the secondary employers' purchases from the struck firms are decreased only because the public has diminished its purchases of the struck product. On the other hand, when consumer picketing is employed to persuade customers not to trade at all with the secondary employer, the latter stops buying the struck product, not because of a falling demand, but in response to pressure designed to inflict injury on his business generally. In such case, the union does more than merely follow the struck product; it creates a separate dispute with the secondary employer. (377 U.S. 58, at 72.)

In the present case, Respondents' activities were directed towards the institution of a consumer boycott of all products distributed by the companies it listed as advertising on KXTV. In these circumstances, it is clear that its appeals and related conduct were not limited to the product in dispute,

---

<sup>8</sup> *N.L.R.B. v. Fruit and Vegetable Packers and Warehousemen, Local 760, et al. (Tree Fruits)*, 377 U.S. 58.

whether that product be reviewed as the physical product advertised over the facilities of KXTV,<sup>9</sup> or as merely the advertising component added to the product by KXTV's efforts.<sup>10</sup> By failing to limit its activities to the product in dispute, Respondent exceeded the limited privilege to engage in product boycotts which the *Tree Fruits* decision recognized. Accordingly, apart from the consideration of the effect of the publicity proviso discussed hereafter, we find that such conduct clearly constitutes threats, restraint, or coercion within the meaning of Section 8(b)(4)(ii) of the Act.

Having found that the actions previously described are coercive, we now consider whether they were protected by the proviso to Section 8(b)(4), and conclude, as we did in our earlier decision, that they were so protected.

Since the remand by the Court of Appeals for the Ninth Circuit, the Supreme Court has considered the scope of the proviso in *N.L.R.B. v. Servette, Inc.*, 377 U.S. 46. In *Servette*<sup>11</sup> we had followed our earlier ruling in *Lohman Sales Co.*, 132 NLRB 901, that products "produced by an employer" included products distributed by a wholesaler with whom the primary dispute existed. The Court of Appeals for the Ninth Circuit, applying its decision in the instant case that the proviso only covered the manufacturer of a physical product, reversed the Board (310 F. 2d 659). The Supreme Court, in turn reversed the Ninth Circuit, and approved of the Board's interpretation pointing out that:

---

<sup>9</sup> Compare the discussion, *infra*, as to the nature of the product produced by KXTV for purposes of applying the proviso to 8(b)(4).

<sup>10</sup> Respondent's activities were not and could not have been confined to a boycott of only the advertising component.

<sup>11</sup> 133 NLRB 1501.

The proviso was the outgrowth of a profound Senate concern that the union's freedom to appeal to the public for support of their case be adequately safeguarded. \* \* \* It would fall far short of achieving this basic purpose if the proviso applied only in situations where the union's labor dispute is with the manufacturer or processor. \* \* \* There is nothing in the legislative history which suggests that the protection of the proviso was intended to be any narrower in coverage than the prohibition to which it is an exception. \* \* \* (377 U.S. 46, at 55).

While *Servette* and *Lohman* both involved wholesalers of a physical product, we are of the opinion that the Supreme Court's decision in *Servette* sustains our holding, enunciated in *Lohman*, that "producer," as used in the proviso encompasses anyone who enhances the economic value of the product ultimately sold or consumed, i.e., for the purposes of the proviso, no distinction is drawn between processors, distributors and those supplying services. Since the Court has stated that the protection of the proviso is not "any narrower in coverage than the prohibition to which it is an exception," and since the prohibition of Section 8(b)(4)(B) covers the performance of services as well as processing or distribution of physical products, it follows that the proviso likewise applies to the performance of services.

Accordingly, with all due respect to the Ninth Circuit's contrary view in this case,<sup>12</sup> we adhere to our original conclusion that KXTV, by the addition of its services (advertising) to the products involved here, is a "producer" within the meaning of the

---

<sup>12</sup> In a decision issued October 29, 1964, *N.L.R.B. v. Joint Council of Teamsters, No. 38, et al.*, — F. 2d — footnote 3, the Ninth Circuit has itself recognized that the Supreme Court's decision in *Servette* extends the proviso to encompass "services."

proviso. Thus, even though the handbilling and related conduct calling for a consumer boycott of secondary employers was coercive, it nevertheless was protected by the proviso to Section 8(b)(4) of the Act.<sup>13</sup>

Having concluded that the intervening decisions of the Supreme Court in *Servette* and *Tree Fruits* support our original holding, with all due respect to the Court of Appeals, we find it unnecessary to reach and pass upon the second question raised in its remand, namely, whether or not the actions were protected by the free press and free speech provisions of the first Amendment to the Constitution. That issue would arise only if we found the actions were coercive and not protected by the proviso to that section of the Act.<sup>14</sup>

In summary, we have found that, with but one exception, Respondents' conduct did constitute threats, restraint or coercion within the meaning of Section 8(b)(4)(ii)(B) of the Act, but that it is not violative

---

<sup>13</sup> Our conclusion is buttressed by the Supreme Court's observation in *Tree Fruits* that by the proviso, Congress authorized: "\* \* \* publicity other than picketing which persuades the customers of a secondary employer to stop all trading with him, but not such publicity which has the effect of cutting off his deliveries or inducing his employees to cease work." (377 U.S. 58, at 70-71.)

<sup>14</sup> The Board has consistently taken the position that as an administrative agency created by Congress it will presume the constitutionality of the Act it is charged with administering, absent binding court decisions to the contrary, *Milk Drivers and Dairy Employees, Local 537 (Sealttest Foods)*, 147 NLRB No. 35; *Chauffeurs, Teamsters, and Helpers General Local Union No. 20 (Milwaukee Cheese Co.)*, 144 NLRB 826; *Truck Drivers Local 413 (Patton Warehouse)*, 140 NLRB 1474. Moreover, the Supreme Court in *Tree Fruits* demonstrated the propriety of avoiding the constitutional problem in this difficult area, if possible. Our interpretation of the proviso does so.

of the Act because of the protection afforded by the publicity proviso. We accordingly reaffirm our original dismissal of the complaint.

Dated, Washington, D.C.

FRANK W. McCULLOCH, *Chairman,*

BOYD LEEDOM, *Member,*

JOHN H. FANNING, *Member,*

(SEAL)

*National Labor Relations Board.*







# United States Court of Appeals

FOR THE NINTH CIRCUIT

---

GREAT WESTERN BROADCASTING CORPORATION,  
d/b/a KXTV, *Petitioner*

v.

NATIONAL LABOR RELATIONS BOARD, *Respondent*

---

On Supplemental Petition to Review Supplemental  
Decision of the National Labor Relations Board

---

## BRIEF FOR PETITIONER

---

FILED

AUG 20 1960

WINTHROP A. JOHNS  
1120 Tower Building  
Washington, D. C. 20005

FRANK H. SCHMIDT, *Attorney for Great Western Broadcasting Corporation, d/b/a KXTV, Petitioner*

*Of Counsel:*

REILLY AND WELLS  
1120 Tower Building  
Washington, D. C. 20005



## SUBJECT INDEX

	Page
I. STATEMENT OF THE CASE .....	2
II. SPECIFICATION OF ERRORS .....	7
III. ARGUMENT .....	8
A. Summary of Argument .....	8
B. "Products" "Produced" and "Distributed" by KXTV .....	9
C. The Court's Decision in No. 17,698 .....	11
D. The Supreme Court's Decisions in <i>Tree Fruits</i> and <i>Servette</i> , and this Court's Reference thereto in <i>Joint Council of Teamsters</i> .....	12
E. This Court's Decision in No. 17,698 Remains the Law-of-the-Case .....	15
F. This Court's Interpretation of the Proviso in this Matter Does not Impinge upon the Unions' Constitutional Rights Regarding Free Speech and Free Press .....	16
IV. CONCLUSION .....	19
APPENDIX A (Court's decree) .....	21
APPENDIX B (Court's opinion) .....	22

## AUTHORITIES CITED

### CASES:

<i>Carpenters &amp; Joiners Union v. Ritter's Cafe</i> , 315 U.S. 722 .....	17
<i>Columbia Broadcasting System, Inc. v. Amana Refrigeration, Inc.</i> , 295 F.2d 375 (C.A. 7), cert. denied 369 U.S. 812 .....	15
<i>Giboney v. Empire Storage &amp; Ice Co.</i> , 336 U.S. 490 ....	17
<i>Great Western Broadcasting Corp. v. N.L.R.B.</i> , 310 F.2d 591 (C.A. 9) .....	2, 6, 8, 11, 13, 22

	Page
<i>International Brotherhood of Electrical Workers v. N.L.R.B.</i> , 341 U.S. 694 .....	18
<i>Lohman Sales Co.</i> , 132 NLRB 901 .....	13
<i>Middle South Broadcasting Co.</i> , 133 NLRB 1698 .....	13
<i>N.L.R.B. v. Fruit &amp; Vegetable Packers &amp; Warehousemen, Local 760 (Tree Fruits)</i> , 377 U.S. 58.....	7, 8, 10, 12, 17
<i>N.L.R.B. v. Joint Council of Teamsters, No. 38</i> , 338 F.2d 23 (C.A. 9) .....	7, 8, 15
<i>N.L.R.B. v. Serrette, Inc.</i> , 377 U.S. 46 .....	7, 8, 12, 13, 14, 15, 17
<i>N.L.R.B. v. United Brotherhood of Carpenters</i> , 184 F.2d 60 (C.A. 10) .....	19
<i>Pet Milk Co. v. Boland</i> , 185 F.2d 298 (C.A. 8) .....	16
<i>Servette, Inc. v. N.L.R.B.</i> , 310 F.2d 659 (C.A. 9) .....	12
<i>Shevlin-Hixon Co. v. Smith</i> , 165 F.2d 170 (C.A. 9) ....	15
<i>W. T. Smith Lumber Co. v. N.L.R.B.</i> , 246 F.2d 129 (C.A. 5) .....	16
<i>Thomas v. Collins</i> , 323 U.S. 516 .....	17
<i>Thornhill v. Alabama</i> , 310 U.S. 88 .....	18
<i>Todd v. Commissioner of Internal Revenue</i> , 165 F.2d 781 (C.A. 9) .....	16
<i>United Brotherhood of Carpenters v. Sperry</i> , 170 F.2d 863 (C.A. 10) .....	19
<i>United States v. Montgomery Ward Co.</i> , 150 F.2d 369 (C.A. 7) .....	13
<i>Vincent v. Steamfitters Local Union 395</i> , 288 F.2d 276 (N.D.N.Y.) .....	19
<i>Ypsilanti Press, Inc.</i> , 135 NLRB 991 .....	9

## STATUTES:

National Labor Relations Act (29 U.S.C. Sec. 141)	
Section 8(b) (4) (ii) (B) .....	4, 16
Section 10(f) .....	1
Section 10(l) .....	5
Fair Labor Standards Act (29 U.S.C. Sec. 203(j)) ....	13
Clayton Act (15 U.S.C. Sec. 13(a), 14)	
Sections 2(a) and (3) .....	15
War Labor Disputes Act .....	13

# United States Court of Appeals

FOR THE NINTH CIRCUIT

---

No. 20,106

---

GREAT WESTERN BROADCASTING CORPORATION,  
d/b/a KXTV, *Petitioner*

v.

NATIONAL LABOR RELATIONS BOARD, *Respondent*

---

**On Supplemental Petition to Review Supplemental  
Decision of the National Labor Relations Board**

---

## **BRIEF FOR PETITIONER**

---

This is a proceeding under Section 10(f) of the National Labor Relations Act (29 U.S.C. Sec. 141 *et seq.*; herein called the Act) to review the Supplemental Decision of the National Labor Relations Board (herein called the Board) issued on December 16, 1964, in response to this Court's decree of December 17, 1962, entered in the prior proceeding herein identified on the Court's records as No. 17,698 (the decree in No. 17,698 is set forth in Appendix A



hereto). It is conceded that this Court has jurisdiction to review the Supplemental Decision herein under Section 10(f) of the Act, as it did the original decision and order in this matter. The alleged unfair labor practices occurred in, and the respondents before the Board transact business within, this judicial circuit.

## I. STATEMENT OF THE CASE

Petitioner herein, the charging party before the Board, operates a television station at Sacramento, California, known as KXTV (O.R. 39, 86).<sup>1</sup> American Federation of Television & Radio Artists, San Francisco Local (often called AFTRA), and National Association of Broadcast Employees & Technicians, Local 55 (often called NABET; both being respondents in the proceedings before the Board and herein jointly called the Unions), who represented some of KXTV's employees, on about September 26, 1960, struck and began picketing KXTV's station (O.R. 85). In support of their strike, the Unions embarked on a concentrated campaign to induce secondary employers to cease advertising over petitioner's television station, KXTV, or, in other words, to cease doing business with KXTV. This campaign was summarized in this Court's opinion of November 9, 1962, in No. 17,698 (310 F.2d, at pp. 593-594),<sup>2</sup> as follows: the Unions—

“(1) had committees of the unions call upon all of the advertisers who used KXTV for the purpose of requesting them to discontinue their patronage of the

---

<sup>1</sup> By stipulation of the parties the printed Transcript of Record filed in No. 17,698 has been incorporated as part of the record in this proceeding; only the proceedings subsequent to the remand are contained in the Supplemental Transcript of Record filed herein. The abbreviations “O.R.” identify references to the pages of the printed Transcript of Record in No. 17,698; the abbreviations “S.R.” identify references to pages of the Supplemental Transcript of Record.

<sup>2</sup> This Court's opinion in No. 17,698 is set forth in Appendix B hereto noting the Federal Reporter System pagination.

station and assist the unions in their cause against KXTV;

“(2) had a committee call upon Capitol<sup>3</sup> for the same purpose, in the course of which this advertiser was told that if it continued to advertise on KXTV the Labor Council would undoubtedly print the name of Capitol in the Labor Bulletin as not supporting the strike;

“(3) mailed to all KXTV advertisers a letter setting forth the background of the strike and requesting discontinuance of advertising over the station, warning that failure to do so would bring an adverse economic reaction;

“(4) printed and distributed four thousand handbills listing KXTV as ‘unfair’, and naming Geer, Rainbo, Shell and Burgermeister<sup>4</sup> as advertisers who nevertheless continued to utilize the services of the station, such distribution being made in front of KXTV, at the Sacramento Labor Temple, and at various Sacramento grocery stores which handled Rainbo bread and Burgermeister beer;<sup>5</sup>

“(5) sent a letter to the San Francisco Labor Council asking the Council to return its Shell credit card to that company and to request the members of affiliated unions to do likewise;

“(6) sent a later letter to the San Francisco Labor Council listing fourteen companies who were then advertising on station KXTV,<sup>6</sup> with the observation that ‘any aid’ the Council and its affiliated members ‘can give in this sponsor area’ would be appreciated;

---

<sup>3</sup> Capitol Studebaker Company, an automobile dealer in Sacramento (O.R. 85-87).

<sup>4</sup> John Geer Chevrolet Company, an automobile dealer in Sacramento; Rainbo Baking Company, a Sacramento bakery engaged in the baking and sale of bread and other baked products; Shell Oil Company, a national gasoline service station chain with stations in Sacramento; Burgermeister Brewing Corporation, a California beer manufacturer and distributor (O.R. 85-86).

<sup>5</sup> Copies of this leaflet were also found stuffed between loaves of bread at a supermarket supplied by Rainbo.

<sup>6</sup> In addition to Geer and Shell, those named were Blue Seal Bread; Hamm’s Beer; Continental Baking Co.; Dr. Layne, Optometrist; Belkins Moving & Storage; and Crocker-Anglo Bank (O.R. 119-120).

“(7) showed to the President of Handy-Andy,<sup>7</sup> with an appeal to stop advertising on KXTV, a copy of a newly-printed leaflet which gave the background of the labor dispute with KXTV, named Handy-Andy as a company which continued to do business with KXTV, and added the comment: ‘We think you will agree that this continued association is contrary to the best interests of working people, and the public’;

“(8) telephoned the general manager of Geer and, in conjunction with an appeal to have Geer cease advertising on KXTV, informed him that a new leaflet was being printed naming Geer as a sponsor still advertising on KXTV and that if Geer continued to do business with the station, this leaflet would be passed out in front of Geer’s establishment, among other places.

“As a result of the described union activity one KXTV advertiser was subjected to a secondary boycott and at least two other advertisers ceased doing business with that station.” [footnotes omitted]

The Court’s summation is fully supported by the record (O.R. 85-93, 97-131).

Upon charges and amended charges (O.R. 3-18) filed by petitioner, alleging an unlawful consumer secondary boycott under Section 8(b) (4) (ii) (B) of the Act,<sup>8</sup> the General

<sup>7</sup> Handy-Andy is a Sacramento television and appliance retail store (O.R. 88).

<sup>8</sup> Section 8(b) (4) (ii) (B) provides, in pertinent part:

“(b) It shall be an unfair labor practice for a labor organization or its agents—

\* \* \* \* \*

“(4) \* \* \* (ii) to threaten, coerce, or restrain any person engaged in commerce or in an industry affecting commerce, where \* \* \* an object thereof is—

\* \* \* \* \*

“(B) forcing or requiring any person to cease using, selling, handling, transporting, or otherwise dealing in the products of any other producer, processor, or manufacturer, or to cease doing business with any other person, \* \* \*

\* \* \* \* \*

“*Provided further*, That for the purposes of this paragraph (4) only, nothing contained in such paragraph shall be construed to prohibit publicity, other than picketing, for the purpose of truthfully advising

Counsel of the Board issued the Complaint herein against the Unions (O.R. 19-27) and secured a Section 10(1) injunction in the District Court for the Northern District of California (191 F.Supp. 676).<sup>9</sup> After hearing, a Trial Examiner of the Board sustained the Complaint (O.R. 38-57) and recommended an order restraining further such activity by the Unions (O.R. 57-59).

Upon exceptions by the Unions (O.R. 60-65), the majority of a three-member panel of the board, on December 27, 1961, reversed the Trial Examiner and dismissed the Complaint (O.R. 65-75), holding that the consumer secondary boycott was permissible under the second proviso to Section 8(b)(4) (see *supra*, p. 4, fn. 8), which exempts from that section—

“\*\*\* publicity, other than picketing, for the purpose of truthfully advising the public, including consumers and members of a labor organization, that a product or products are produced by an employer with whom the labor organization has a primary dispute and are distributed by another employer.”

In rejecting petitioner's argument that it did not “produce” a “product or products” which were “distributed” by its advertisers, the panel majority held that KXTV, “by adding its labor in the form of capital, enterprise and service to the products which it advertises for secondary employers

---

<sup>9</sup> [footnote cont'd]

the public, including consumers and members of a labor organization, that a product or products are produced by an employer with whom the labor organization has a primary dispute and are distributed by another employer, as long as such publicity does not have an effect of inducing any individual employed by any person other than the primary employer in the course of his employment to refuse to pick up, deliver, or transport any goods, or not to perform any services, at the establishment of the employer engaged in such distribution; \* \* \*.”

<sup>9</sup> Section 10(1) of the Act provides for injunctive relief in the district courts against secondary boycotts and certain other unfair labor practices upon “reasonable cause to believe” that a charge alleging such has merit, pending the Board's final decision in the matter.

becomes one of the producers of the product which it advertises" (O.R. 73).

In No. 17,698, this Court, after thorough discussion in its unanimous decision of November 9, 1962 (310 F.2d, at pp. 595-600), concluded, contrary to the Board, that the "publicity proviso . . . does not protect publicity to the effect that television service is rendered by a station with whom the labor organization has a primary dispute, which service is utilized by other employers" (at p. 600). Accordingly, the Court remanded the matter to the Board for determination as to whether the Unions' conduct constituted threats, coercion, or restraint prohibited by Section 8(b)(4)(ii)(B) (*ibid.*). It also returned for Board consideration the Unions' claim that their conduct was protected by the free speech and free press provisions of the Constitution (*ibid.*).

Upon remand, petitioner moved the Board to reopen the record to receive evidence to augment the stipulated record and to receive evidence concerning the Unions' resumption of their intensive customer secondary boycott activities after the District Court injunction was dissolved on November 20, 1961 (S.R. 68-73). The motion was supported by affidavit and exhibits showing that these consumer secondary boycott activities were current at the time of the motions (S.R. 3-67). The Unions opposed reopening of the record (S.R. 74-76), and the motion was denied on February 8, 1963 (S.R. 81). In addition, petitioner filed a new consumer secondary boycott charge with the Board's Regional office. This charge is being held "in abeyance" by the Regional Office.<sup>10</sup>

On December 16, 1964, the Board, in response to this Court's remand of December 17, 1962, issued its Supplemental Decision (S.R. 82-88), which decision is here for review. In its Supplemental Decision, the Board found that the Unions' conduct set forth by the Court in items 2

---

<sup>10</sup> The charge is docketed in the San Francisco Regional Office as Case No. 20-CC-324.



through 8 (*supra*, pp. 2-4) constituted "restraint or coercion within the meaning of Section 8(b)(4)(ii) of the Act" (S.R. 85).<sup>11</sup> Nonetheless, the Board, relying on the intervening decisions of the Supreme Court in *N.L.R.B. v. Servette, Inc.*, 377 U.S. 46, and *N.L.R.B. v. Fruit & Vegetable Packers & Warehousemen, Local 760 (Tree Fruits)*, 377 U.S. 58, and citing this Court's recent decision in *N.L.R.B. v. Joint Council of Teamsters, No. 38*, 338 F.2d 23, 26 fn. 3, adhered to its prior conclusion that "KXTV, by the addition of its services (advertising) to the products involved here, is a 'producer' within the meaning of the proviso," and reaffirmed its dismissal of the Complaint (S.R. 87-88). On the free speech issue, the Board presumed the constitutionality of the statute without meeting the issue (S.R. 88, fn. 14).

## II. SPECIFICATION OF ERRORS

1. The Board erred in holding that the Unions' coercive consumer secondary boycott activities were protected by the proviso to Section 8(b)(4) of the Act in disregard of this Court's prior decision to the contrary.

2. The Board erred in holding that the Unions' coercive consumer secondary boycott activities were protected by the proviso to Section 8(b)(4) of the Act, in disregard of the clear meaning and intent of the proviso.

3. The Board erred in holding that KXTV became a "producer" of the "products" advertised over its station by "the addition of its services (advertising)."

4. The Board erred in holding that KXTV became a "producer" of "products" by the advertisement of "services," not only products, over its station.

---

<sup>11</sup> The Board found that item 1 involved "a mere request to neutral employers unaccompanied by any coercive acts" and, therefore, was not "prohibited activity within the meaning" of the section (S.R. 84-85). Petitioner disagrees with this conclusion because the conduct was part of a total course of unlawful action. Nevertheless, petitioner does not seek reversal of this conclusion here.



5. The Board erred in failing to distinguish between situations where “services” physically contribute to the production of a product for the market—as does transportation of the product, or distributing or wholesaling—and services—such as advertising—which make no contribution whatsoever to the production of a product but serve only to produce customers for a product or a service.

### III. ARGUMENT

#### A. Summary of Argument

This Court, in No. 17,698, decided that the advertising services of KXTV did not make KXTV a producer of the “automobiles, bread, gasoline and beer” distributed by its advertisers (310 F.2d, at p. 596), or a producer of products by advertising “a service, such as banking or cleaning” (*ibid.*, at p. 597). Nothing in *N.L.R.B. v. Servette, Inc.* 377 U.S. 46, or *N.L.R.B. v. Fruit & Vegetable Packers & Warehousemen, Local 760 (Tree Fruits)*, 377 U.S. 58, relied upon by the Board, or in *N.L.R.B. v. Joint Council of Teamsters, No. 38*, 338 F.2d 23 (C.A. 9), cited by the Board, in any respect disturbs the foregoing prior conclusions of this Court. The *Tree Fruits* decision treats with an entirely different aspect of the application of the publicity proviso to Section 8(b)(4) of the Act. The *Servette* and *Joint Council of Teamsters* cases hold merely that this Court’s decision went too far in No. 17,698 insofar as it was later construed by this Court in *Servette* to hold that services of a wholesaler or distributor who physically handled tangible goods enroute to the market place, was not a producer of the tangible products offered for sale to the public. There is nothing in either decision that even suggests that a television station by advertising a product becomes a producer of such product within the meaning of the publicity proviso. The Board having found that the Unions’ conduct constituted prohibited activities for a proscribed object under Section 8(b)(4)(ii)(B) of the Act, this Court should reverse the Board’s dismissal of the Complaint and enforce

the Trial Examiner's recommended order, or remand the case to the Board for entry of an order not inconsistent with the Court's determination that the publicity proviso did not protect the Unions' consumer secondary boycott activities. There is no constitutional impediment to this Court's interpretation of the publicity proviso.

**B. "Products" "Produced" and  
"Distributed" by KXTV**

It may be appropriate here to review the so-called "products" "produced" by KXTV which the Board claims are being "distributed" by its advertisers. According to the Board, they consist of all the products advertised over KXTV and distributed by the advertisers because "by the addition of its services (advertising) to the products involved here, [KXTV] is a 'producer' within the meaning of the proviso" (S.R. 88). But KXTV contributes no services in the production of the products being distributed by its advertisers at any time from inception to the final distributional point to the customer. KXTV does not handle or otherwise work on the products being so distributed. The advertising services KXTV furnishes contribute not to the production of the advertised articles but to the production of customers for them after they are produced. It likewise produces customers for the services, such as banking and moving and storage services, advertised on its station, not the services themselves; nor are these services so advertised products themselves.

If advertising were deemed to make the advertising medium the producer of the products it advertised, this would apply to all advertising media, including newspapers and magazines. (The Board, in fact, has extended this view to newspapers. See *Ypsilanti Press, Inc.*, 135 NLRB 991, 997-998.) But this is absurd. The "products" "produced" by the publishers are the tangible objects—the newspapers and magazines themselves. Under the publicity proviso those "products" could be boycotted at the newsstands, tobacco shops, drugstores, etc., where "distributed."

There is no occasion for a strained application of the proviso to these advertising media which would permit unions having primary disputes with the media to go *backwards* and boycott the advertisers. The proviso on its face plainly is intended to permit products to be followed *forward only* from the point of the primary dispute to the point where the products are being distributed—*not backwards*. See *N.L.R.B. v. Fruit & Vegetable Packers & Warehousemen, Local 760 (Tree Fruits)*, 337 U.S. 58, 64, fn. 7.

If the proviso were construed to permit unions having primary labor disputes with newspapers and magazines to back-up and boycott the latter's advertisers, it would also mean that in a *Servette* situation the union would be permitted to back-up to the manufacturers of the products being handled by the wholesaler and conduct a general consumer boycott of those products. But then the disputed products would become the ones manufactured by the manufacturer, *not the ones handled by the wholesaler*. The same is true in respect to advertising media. If unions are permitted to boycott newspaper and magazine advertisers, the disputed products would become the products of the advertisers, not the publishers' products—the newspapers and the magazines.

Like newspaper and magazine publishers, television and radio stations produce products of their own which are distributed to the public. The products are the television and radio programs, consisting of news-casts, music, plays, advertising, etc., which are distributed to the public over the wave-length assigned to the station. Distribution of this product to the public may be shut-off under the proviso by a consumer appeal not to listen to the station's wave-length. Were an establishment distributing a program generated by the station to its clientele, the proviso might protect a consumer boycott of such an establishment because of its distribution of the product of the station—but not because it may be an advertiser on the station. But in the instant

matter, KXTV's advertisers neither handle nor distribute KXTV's product—its programs.

Nothing in the foregoing is inconsistent with this Court's decision in No. 17,698. These views merely advance additional arguments showing that the conclusion of the Court in No. 17,698 was proper.

### **C. The Court's Decision in No. 17,698**

The conclusion of the Court in No. 17,698 was that the "publicity proviso . . . does not protect publicity to the effect that television service is rendered by a station with whom the labor organization has a primary dispute, which service is being utilized by other employers" (310 F.2d, at p. 600). As foundation for this conclusion, the Court noted (1) that "as all seem to recognize, the context in which the term 'product' appears in the proviso precludes the view that the television service rendered by KXTV, considered alone, is a 'product' within the meaning of the proviso" (*ibid.*, at p. 595); (2) that a "more persuasive reason why television advertising service, considered alone, could not be a 'product' lies in the fact that an advertising service rendered by a television station is not capable of being 'distributed' by an employer whose only relationship with the station is that of an advertiser" (*ibid.*, at p. 596); (3) that it is a "rather remarkable conclusion that a television station can be a producer of automobiles, bread, gasoline and beer" (*ibid.*); (4) that the "Board is still saying that a service, though one being advertised rather than the television service itself, is a 'product,' although not capable of being distributed" and "has involved itself in the additional difficulty of saying that a television station is a 'producer' of banking and cleaning services which are 'distributed' by banks and cleaners" (*ibid.*, at p. 597); and (5) that the "only primary employers referred to in the enacted proviso are those who produce a product or products . . . capable of distribution" (*ibid.*, p. 600).

However, by way of dictum the Court in No. 17,698 indicated that it did not believe that Congress in general intended the "publicity proviso to apply with regard to a primary employer who renders services instead of manufactures tangible articles" (*ibid.*, at pp. 596, 597). Subsequently, in *Servette, Inc. v. N.L.R.B.*, 310 F.2d 659, this Court, relying on the foregoing language in No. 17,698, held that a distributor who handles tangible products in the chain of their production from the manufacturer to the consuming public "does not produce" the "products" he handles within the meaning of the proviso (*ibid.*, at p. 667).

**D. The Supreme Court's Decisions in Tree Fruits and Servette, and this Court's Reference thereto in Joint Council of Teamsters**

The *Tree Fruits* case (*N.L.R.B. v. Fruit & Vegetable Packers & Warehousemen, Local 760*, 377 U.S. 58) treats with the question of whether picketing of retailers who distributed tangible products of the primary employers, namely apples, with signs limited to the products of the primary employers violated the proviso. The conclusion was that the picketing, so limited, did not violate the proviso or the Act. Plainly, this limited holding has no bearing on this Court's decision in No. 17,698.

In *Servette* (*N.L.R.B. v. Servette, Inc.*, 377 U.S. 46), the Supreme Court reviewed and reversed this Court's decision in that case referred to above (p. 12). However, it is clear that the reversal was restricted to this Court's dictum in No. 17,698, applied in its *Servette* decision, to the effect that the publicity proviso was not intended "to apply with regard to a primary employer who renders services [like a distributor] instead of manufactures tangible articles" (*supra*, p. 12). The Supreme Court's cautious treatment of the *Servette* question, involving a distributor who handled and transported tangible goods in the chain of production from manufacturer to consuming public, plainly discloses no intent on the part of the Supreme Court to disturb



the decision of this Court in respect to the basic holding in No. 17,698, namely, that the advertising services furnished by KXTV to its advertisers does not make KXTV the producer of the products and services of its advertisers.

Although the Supreme Court twice in *Servette* (377 U.S., at pp. 55, 56) mentioned this Court's decision in No. 17,698, it at no time alluded to this Court's basic holding that the proviso does not protect consumer secondary boycott activities against advertisers over a television station with which latter the union has a primary dispute. Also, while the Supreme Court in sustaining the Board in *Servette* mentioned the Board's decision in *Lohman Sales Co.*, 132 NLRB 901 (377 U.S., at p. 55), which involved another distributor in the chain of production from manufacturer to consumer, it made no reference to the Board's decision in either this case or *Middle South Broadcasting Co.*, 133 NLRB 1698. It was in the latter case that the Board initially enunciated the theory that by furnishing advertising services a radio station becomes the producer of the products of the advertiser, and it was on the decision in that case that the initial decision of the Board in this matter was bottomed. Furthermore, the Supreme Court ignored the broad definitions of "product" and "production" relied upon by the Board in *Lohman* (132 NLRB, at pp. 906-907), and urged before this Court in No. 17,698 (see 310 F.2d, at pp. 596-597, fn. 11).

Instead, the Supreme Court (1) relied on the definitions of "produced" and "production" appearing in the Fair Labor Standards Act (29 U.S.C. Sec. 203 (j)), which limit the meaning of the term "produced" to "produced, manufactured, mined, handled, or in any other manner worked on," and the term "production" to "producing, manufacturing, mining, handling, transporting, or in any other manner working on" (377 U.S., at pp. 55-56);<sup>12</sup> (2) re-

<sup>12</sup> *United States v. Montgomery Ward & Co.*, 150 F.2d 369 (C.A. 7), cited by the Supreme Court in *Servette* (377 U.S., at p. 56, fn. 15), looked at these definitions for guidance for interpretation of the term "production" as used in the War Labor Disputes Act (150 F.2d, at pp. 376-377).



ferred to the fact that the Teamsters Unions were a "primary target" of the 1959 secondary boycott amendments (*ibid.*, at p. 55), and that they represent the "employees not of manufacturers, but of motor carriers" (*ibid.*); and (3) held that the proviso applied to "products distributed, as here, by a wholesaler with whom the primary dispute exists" (*ibid.*, at pp. 55, 56).

Thus, while holding that the term "producer" "must be given a broader reach" than in No. 17,698 in respect to wholesalers and others in the transportation industry (*ibid.*, p. 56), the Supreme Court carefully refrained from even intimating that this was so in respect to the advertising services of a television station. To the contrary, the Supreme Court's disregard of the all-encompassing definitions of "product" and "production" advanced by the Board, and reliance only on the restrictive definitions requiring physical contact with a tangible product, plainly indicates the Supreme Court's rejection of the Board's extreme position in this matter.

The dictum of the Supreme Court in *Servette* that "There is nothing in the legislative history which suggests that the protection of the proviso was intended to be any narrower in coverage than the prohibition to which it is an exception" must be read in the light of the Supreme Court's conclusion that the Teamsters Unions were a "primary target" of the legislative purpose, rather than as a judicial endorsement of the proviso's extension to an irrational extreme. Had the Supreme Court intended to reverse the KXTV holding of this Court in No. 17,698, it would not have been so selective in the language it chose. It could easily have chosen language which would have embraced television stations, which advertise products of other employees, with employers who engage in "wholesale distribution of goods," as producers within the meaning of the proviso if this were what was intended (see 377 U.S., at p. 56). The failure of the Supreme Court to do so is eloquent. This Court's deci-

sion in No. 17,698, on the question directly involved, remains, therefore, unchallenged.

In *N.L.R.B. v. Joint Council of Teamsters*, No. 38, 338 F.2d 23, this Court properly stated that the Supreme Court's decision in *Servette* "requires that the term 'products' . . . be read to include services furnished by an employer performing a distribution function" (at p. 26). It did not, however, suggest that an advertising service makes the advertising medium a producer of the advertiser's products. The definitions relied upon by the Supreme Court in *Servette* foreclose such a conclusion. KXTV at no time assisted in the production of its advertisers' products by "handling, transporting, or in any other manner working on" them. Its services were designed to produce the customers, not the products.

Recently, the Seventh Circuit, in *Columbia Broadcasting System, Inc. v. Amana Refrigeration, Inc.*, 295 F.2d 375, 398, cert. denied 369 U.S. 812, aptly characterized a contract for advertising time on a television station as "a purchase by [the advertiser] of the privilege of having itself identified as sponsor of the program broadcast and making use of the permissible portion thereof for advertising *its products*" (emphasis added). In the same decision, the Seventh Circuit held that television advertising was not a sale of a "commodity" within the meaning of Sections 2(a) and (3) of the Clayton Act (15 U.S.C. Sec. 13(a), 14).

#### **E. This Court's Decision in No. 17,698 Remains the Law-of-the-Case**

The recent decisions of the Supreme Court, as shown, in no respect undermine this Court's legal conclusion in No. 17,698 that the "publicity proviso" "does not protect publicity to the effect that television service is rendered by a station with whom the labor organization has a primary dispute, which service is being utilized by other employers" (*supra*, pp. 12-15). This Court in *Joint Council of Team-*

sters has properly recognized the limitation of the Supreme Court's *Servette* decision (*supra*, p. 15).

Under these circumstances, the Court's decision in No. 17,698 remains, untarnished, as the law-of-the-case and was improperly disregarded by the Board on the remand. The Eighth Circuit, in *Pet Milk Co. v. Boland*, 185 F.2d 298, 300-301, succinctly sets forth the law-of-the-case doctrine, as follows:

... Stated generally, the rule is that, "where evidence is substantially the same on both trials, questions of law determined on . . . appeal are 'law of the case,' both for trial court and appellant court, on second . . . appeal."

This Court has applied this rule also following a limited remand, as here. *Todd v. Commissioner of Internal Revenue*, 165 F.2d 781 (C.A. 9); see also *Sherlin-Hixon Co. v. Smith*, 165 F.2d 170, 178 (C.A. 9); cf. *W. T. Smith Lumber Co. v. N.L.R.B.*, 246 F.2d 129 (C.A. 5).

No new evidence was taken on the remand; the factual record here is precisely what it was when this matter was before the Court in No. 17,698, except for the additional findings and conclusions of the Board that the Unions' conduct constituted coercion and restraint within the meaning of Section 8(b)(4)(ii)(B) of the Act. The law-of-the-case doctrine plainly is applicable and forecloses departure from the legal conclusions in No. 17,698.

**F. This Court's Interpretation of the Proviso in this Matter Does Not Impinge upon the Unions' Constitutional Rights Regarding Free Speech and Free Press**

Although the Court remanded this question to the Board for consideration, it seems that the Court, itself, answered the question in No. 17,698 when it stated that "Section 8(c) of the Act . . . provided complete implementation of the First Amendment" and that this section "does not protect under the guise of free speech, publicity activity which is

associated with coercion" (310 F.2d, at p. 599). Here the Board, itself, has found that the Unions' publicity was coercive. No more is required.

The Supreme Court has twice recently reviewed the prohibition against coercion and restraint contained in Section 8(b)(4)(ii)(B), as limited by the publicity proviso (*Tree Fruits* and *Servette*, *supra*, p. 12), and, except for one concurring judge (in *Tree Fruits*, 377 U.S. at pp. 76-80), has found nothing unconstitutional in the restrictions of the section.

As the Supreme Court stated in *Giboney v. Empire Storage & Ice Co.*, 336 U.S. 490, 502:

"it has never been deemed an abridgement of freedom of speech or press to make a course of conduct illegal merely because the conduct was in part initiated, evidenced, or carried out by means of language, either spoken, written, or printed."

Previously, in *Thomas v. Collins*, 323 U.S. 516, 537-538 (and again in *Giboney*, 336 U.S., at p. 503, fn. 6), the Supreme Court, speaking of the constitutional guarantee of the right of peaceful persuasion, stressed:

"When to this persuasion other things are added which bring about coercion, or give it that character, the limit of the right has been passed, cf. *National Labor Relations Board v. Virginia Electric & Power Co.* [314 U.S. 469, 477-478]. But short of that limit the employer's freedom cannot be impaired. The Constitution protects no less the employees' converse right. Of course espousal of the cause of labor is entitled to no higher constitutional protection than the espousal of any other lawful cause."

Earlier, in *Carpenters & Joiners Union v. Ritter's Cafe*, 315 U.S. 722, in respect to a factual situation strikingly similar to the one here, the Supreme Court upheld the right of a state to limit the exercise of freedom of speech in connection with a labor dispute. In that case, Ritter, the owner

of a cafe, had contracted for the construction of a building a mile and a half from the cafe. A dispute developed between the contractor and the union and the union commenced picketing the cafe with the resulting "curtailment of sixty per cent of Ritter's business." The Supreme Court, citing the absence of any dispute with Ritter over the operation of his restaurant, sustained a state court injunction enjoining the picketing of the cafe under the state anti-trust law "prohibiting the exercise of concerted pressure directed at the business, outside the economic context of the real dispute, of a person whose relation to the dispute arises from dealings with one of the disputants" (*ibid.*, at p. 726). The Supreme Court, holding that the injunction was not an unlawful abridgement of constitutional rights, quoted (*ibid.*, at p. 728) the following from its earlier decision in *Thornhill v. Alabama*, 310 U.S. 88, 103-104:

"We must be mindful that 'the rights of employers and employees to conduct their economic affairs and to compete with others for a share in the products of industry are subject to modification or qualification in the interests of the society in which they exist. This is but an instance of the power of the State to set the limits of permissible contest open to industrial combatants.' "

The factual situation here is substantially similar—"concerted activities directed at" automobile dealers, bakeries, gasoline distributors, breweries, a moving and storage company, a bank, etc., "outside of the economic context of the real dispute" with KXTV (a television station), "whose relation to the dispute arises from dealings" with KXTV concerning advertising.

Subsequently, the Supreme Court upheld the constitutionality of the 1947 secondary boycott amendments to the Act in *International Brotherhood of Electrical Workers v. N.L.R.B.*, 341 U.S. 694, stating (at p. 705) that:

"The prohibition of inducement or encouragement of secondary pressure by § 8(b)(4)(A) carries no un-



constitutional abridgement of free speech. The inducement or encouragement in the instant case took the form of picketing followed by a telephone call emphasizing its purpose. The constitutionality of § 8(b)(4) (A) is here questioned only as to its possible relation to the freedom of speech guaranteed by the First Amendment. This provision has been sustained by several Courts of Appeals. The substantive evil condemned by Congress in § 8(b)(4) is the secondary boycott and we recently have recognized the constitutional right of states to proscribe picketing in furtherance of comparably unlawful objectives. There is no reason why Congress may not do likewise."

In doing so, the Court cited with approval (*ibid.*, at p. 705, fn. 9) the Tenth Circuit's decisions in *N.L.R.B. v. United Brotherhood of Carpenters*, 184 F.2d 60, 62, and *United Brotherhood of Carpenters v. Sperry*, 170, F.2d 863, 868-869, holding that the promulgation of a "blacklist," as well as picketing, in furtherance of a prohibited secondary boycott under the Act was not constitutionally protected. See also *Vincent v. Steamfitters Local Union 395*, 288 F.2d, 276, 278 (N.D.N.Y.), holding that a prohibited secondary boycott under the Act induced by leaflets or handbills was not constitutionally protected.

A prohibited consumer secondary boycott under the Act has no greater constitutional immunity.

#### IV. CONCLUSION

Wherefore, the Court should set aside the Board's Supplemental Decision, reverse the order of dismissal, and either enter a decree adopting the Recommended Order of the Trial Examiner or remand the matter to the Board for



entry of an order consistent with this Court's legal conclusions in No. 17,698.

Respectfully submitted,

WINTHROP A. JOHNS  
1120 Tower Building  
Washington, D. C. 20005

*Attorney for Great Western Broadcasting  
Corporation, d/b/a KXTV, Petitioner*

*Of Counsel:*

REILLY AND WELLS  
1120 Tower Building  
Washington, D. C. 20005

**Certification**

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

/s/ WINTHROP A. JOHNS  
WINTHROP A. JOHNS  
*Attorney for Petitioner*

August 31, 1965

## APPENDIX A

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

GREAT WESTERN BROADCASTING CORPORATION,  
d/b/a KXTV,*Petitioner,*

vs.

NATIONAL LABOR RELATIONS BOARD,

*Respondent*

and

AMERICAN FEDERATION OF TELEVISION AND  
RADIO ARTISTS, SAN FRANCISCO LOCAL AND  
NATIONAL ASSOCIATION OF BROADCAST EM-  
PLOYEES AND TECHNICIANS, LOCAL 55,*Intervenors.*

No. 17698

## Decree

Before: BARNES, HAMLEY and JERTBERG, Circuit Judges.

THIS CAUSE came on to be heard upon the petition of Great Western Broadcasting Corporation d/b/a KXTV, filed December 29, 1961, to review an order of the National Labor Relations Board, issued by it on December 27, 1961, against the petitioner.

The Court heard argument of respective counsel on July 11, 1962 and has considered the briefs and transcript of record filed in this cause. On November 9, 1962 the Court being fully advised in the premises handed down its decision. In conformity therewith, it is hereby,

ORDERED, ADJUDGED AND DECREED that the order of the said National Labor Relations Board under review be and hereby is reversed and that this cause be and hereby is remanded to that agency for consideration, on the present record, with such augmentation thereof, if any, as it may deem appropriate, of the additional questions, raised by intervenors as noted in the opinion of this Court.

FRANK H. SCHMID  
Clerk

Filed and Entered Dec. 17, 1962

## APPENDIX B

319 F.2d 591

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

GREAT WESTERN BROADCASTING CORPORATION,  
d/b/a KXTV,*Petitioner,*

vs.

NATIONAL LABOR RELATIONS BOARD,

*Respondent*

and

AMERICAN FEDERATION OF TELEVISION AND  
RADIO ARTISTS, SAN FRANCISCO LOCAL AND  
NATIONAL ASSOCIATION OF BROADCAST EM-  
PLOYEES AND TECHNICIANS, LOCAL 55,*Intervenors.*

No. 17698

Nov. 9, 1962

On Petition for Review of an Order of  
the National Labor Relations Board[593] Before: BARNES, HAMLEY and JERTBERG, Circuit  
Judges

HAMLEY, Circuit Judge:

This is a proceeding to review an order of the National Labor Relations Board dismissing an unfair labor practice complaint. The case involves an attempt by two unions, assertedly using coercive methods, to force several companies to cease advertising on a television station with which the unions were having a labor dispute. It was charged that the union activity was proscribed by section 8(b)(4)(ii)(B) of the National Labor Relations Act, as amended (Act), 29 U.S.C., § 158(b)(4)(ii)(B).

The charging party, and petitioner here, is Great Western Broadcasting Corporation, which operates television sta-

tion KXTV in Sacramento, California. The unions, which were respondents in the Board proceedings and are intervenors here, are American Federation of Television and Radio Artists, San Francisco Local, and National Association of Broadcast Employees and Technicians, Local 55.

The facts are not in dispute. A primary labor dispute between the unions and KXTV resulted in a strike which commenced on September 26, 1960. Picketing of the KXTV premises ensued. Among the advertisers who then regularly used the services and facilities of KXTV for advertising purposes were John Geer Chevrolet Company (Geer), Capitol Studebaker Company (Capitol), Rainbo Baking Company (Rainbo), Shell Oil Company (Shell), Burgermeister Brewing Corporation (Burgermeister), and Handy-Andy. Each of these advertisers is an employer engaged in commerce or in an industry affecting commerce within the meaning of the Act.

In an effort to win their labor dispute with KXTV, the unions took the following action:

(1) had committees of the unions call upon all of the advertisers who used KXTV for the purpose of **requesting** them to discontinue their patronage of the station and assist the unions in their cause **against** KXTV;

(2) had a committee call upon Capitol for the same purpose, in the course of which this advertiser was told that if it continued to advertise on KXTV the Labor Council would undoubtedly print the name of Capitol in the Labor Bulletin as not supporting the strike;

(3) mailed to all KXTV advertisers a letter setting forth the [594] background of the strike and requesting discontinuance of advertising over the station,

warning that failure to do so would bring an adverse economic reaction;<sup>1</sup>

(4) printed and distributed four thousand handbills listing KXTV as "unfair," and naming Geer, Rainbo, Shell and Burgermeister as advertisers who nevertheless continued to utilize the services of the station, such distribution being made in front of KXTV, at the Sacramento Labor Temple, and at various Sacramento grocery stores which handled Rainbo bread and Burgermeister beer;<sup>2</sup>

(5) sent a letter to the San Francisco Labor Council asking the Council to return its Shell credit card to that company and to request the members of affiliated unions to do likewise;

(6) sent a later letter to the San Francisco Labor Council listing fourteen companies who were then advertising on station KXTV, with the observation that "any aid" the Council and its affiliated members "can give in this sponsor area" would be appreciated;

---

<sup>1</sup> This letter contained these statements:

"... Any advertiser on this station while it is being operated by strike breakers will give the impression of taking sides in this dispute. . . .  
 "... We are about to launch an intensive campaign to bring the facts behind this dispute to the attention of the entire population covered by this station. We are sure you recognize the obvious fact that many members of organized labor and their families, and those sympathetic to the cause of organized labor, will have long-lasting resentment against any product or sponsor who takes sides in this dispute by advertising on this station during the course of this worthy strike.

"If you are currently advertising for clients on this station, or have any advertising projected for the next six months, we are sure you will wish to change your plans to avoid the inevitable adverse reaction. . . ."

<sup>2</sup> Copies of this leaflet were also found stuffed between loaves of bread at a supermarket supplied by Rainbo. The leaflet carried this note:

"This statement is directed to the customers of the above advertisers. It is not a request to employees to refuse to pick up, deliver or transport, or to refuse to perform any service."

(7) showed to the President of Handy-Andy, with an appeal to stop advertising on KXTV, a copy of a newly-printed leaflet which gave the background of the labor dispute with KXTV, named Handy-Andy as a company which continued to do business with KXTV, and added the comment: "We think you will agree that this continued association is contrary to the best interests of working people and the public";<sup>3</sup>

(8) telephoned the general manager of Geer and, in conjunction with an appeal to have Geer cease advertising on KXTV, informed him that a new leaflet was being printed naming Geer as a sponsor still advertising on KXTV and that if Geer continued to do business with the station, this leaflet would be passed out in front of Geer's establishment, among other places.

As a result of the described union activity one KXTV advertiser was subjected to a secondary boycott and at least two other advertisers ceased doing business with that station.<sup>4</sup>

[595] There was no picketing, or threat to picket, the place of business of any of the advertisers. There was no

---

<sup>3</sup> On thousand of these leaflets were printed, and a like number of ten similar leaflets were printed, each naming a different company which continued to advertise on KXTV. None of these leaflets, however, were distributed.

<sup>4</sup> As a result of the first letter sent by the unions to the San Francisco Labor Council, Shell received numerous letters enclosing Shell credit cards. The individual writers explained that they would pick up their cards in the future when Shell discontinued its advertising over KXTV.

On October 10, 1960 Capitol cancelled its \$3,500 advertising contract with KXTV for the duration of the strike. In a letter of explanation, Capitol told KXTV that after its televised commercial one evening, the company's phones were "jammed" from 7:00 to 9:30 P.M. by callers claiming to be union people. These callers criticized Capitol for not supporting the strike and, in substance, said that for this reason they would not do business with the company.

On November 10, 1960, and as a result of the pressure described above, Rainbo cancelled a \$26,000 advertising contract which it had entered into with KXTV a month previously.



physical violence or threat of physical violence. The handbills were truthful and their distribution was peaceful. None of the described union activity was designed to bring about a work stoppage by employees of any advertiser, and none had that effect.

On these facts the Board, with one member dissenting, held that the described union activity was protected by the publicity proviso at the end of section 8(b)(4) of the Act.<sup>5</sup> The complaint was therefore dismissed in its entirety.<sup>6</sup>

Petitioner here challenges the Board conclusion that the publicity proviso is applicable under the facts of this case. It contends that since that proviso pertains only to publicity concerning a "product" or "products" which are "produced" by a primary employer and which are thereafter

---

<sup>5</sup> Section 8(b)(4) provides in pertinent part:

"(b) It shall be an unfair labor practice for a labor organization or its agents—

\* \* \* \* \*

"(4) . . . (ii) to threaten, coerce, or restrain any person engaged in commerce or in an industry affecting commerce, where . . . an object thereof is—

"B. forcing or requiring any person to cease using, selling, handling, transporting, or otherwise dealing in the products of any other producer, processor or manufacturer, or to cease doing business with any other person, . . .

\* \* \* \* \*

"*Provided further*, that for the purposes of this paragraph (4) only, nothing contained in such paragraph shall be construed to prohibit publicity, other than picketing, for the purpose of truthfully advising the public, including consumers and members of a labor organization, that a product or products are produced by an employer with whom the labor organization has a primary dispute and are distributed by another employer, as long as such publicity does not have an effect of inducing any individual employed by any person other than the primary employer in the course of his employment to refuse to pick up, deliver, or transport any goods, or not to perform any services, at the establishment of the employer engaged in such distribution; . . ."

<sup>6</sup> A preliminary injunction against the unions which the Board had obtained, reported *sub nom. Brown v. American Federation of Television & Radio Artists, San Francisco Local*, N.D. Cal., 191 F.Supp. 676, was thereafter dismissed.

“distributed” by another employer, the service rendered by a television station is not included therein.<sup>7</sup>

The Board, as respondent on this review, joins issue on this point. The two unions, which were respondents in the agency proceeding and are intervenors here, support the Board’s position that the publicity proviso is applicable and protects the union activity in question.

In determining which of these conflicting constructions of the proviso is correct, the critical statutory words, none of which are defined in the Act, are “product,” “produced,” and “distributed.”

In its broadest sense, the term “product” denotes anything which is produced. Since economic activity includes the rendition of services, it is appropriate, where the context otherwise permits, to refer to a completed service as a “product.”

In this case, however, as all seem to recognize, the context in which the term “product” appears in the proviso precludes the view that the television service rendered by KXTV, considered alone, is a “product” within the meaning of the proviso.<sup>8</sup> On reason for this con- [596] clusion is the fact that in two other places in section 8(b)(4), the term “services” is used in contradistinction to tangible articles.<sup>9</sup>

---

<sup>7</sup> In support of the same proposition, the National Association of Broadcasters has filed an *amicus curiae* brief in this court.

<sup>8</sup> In holding that the “privilege” which a television network sells to a sponsor is not a “commodity” within the meaning of sections 2(a) and 3 of the Clayton Act, 15 U.S.C., sections 13(a), 14 it has been held that the most reliable guide to the meaning of the word is the context in which it is employed. *Columbia Broadcasting System v. Amana Refrigeration, Inc.*, 7 Cir., 295 F.2d 375, 378.

<sup>9</sup> In section 8(b)(4)(i), the following words are used: “. . . to use, manufacture, process, transport, or otherwise handle or work on any goods, articles, materials, or commodities or to perform any services; . . .” (Emphasis supplied.) Near the end of the publicity proviso itself, the following language appears: “. . . to refuse to pick up, deliver, or transport any goods, or not to perform any services, . . .” (Emphasis supplied.) In section 8(b)(4)(i)

It is likely that Congress would have followed this same format if it had intended the publicity proviso to apply with regard to a primary employer who renders services instead of manufactures tangible articles.

A second and still more persuasive reason why television advertising service, considered alone, could not be a "product" within the meaning of the publicity proviso lies in the fact that the only "products" there referred to are those which are capable of being "distributed" by "another employer." An advertising service rendered by a television station is not capable of being so "distributed," least of all by an employer whose only relationship with the station is that of an advertiser.

The Board, however, believes that it has overcome this difficulty by holding that it is not the television service of KXTV, standing alone, which is the "product" here, but the item being advertised on that station. KXTV becomes one of the "producers" of the items advertised, the Board reasons, "by adding its labor in the form of capital, enterprise and service . . ." to such items.

It may be noted, however, even before testing the correctness of this line of reasoning, that it leads to the rather remarkable conclusion that a television station can be a producer of automobiles, bread, gasoline and beer.<sup>10</sup>

In reaching its conclusion the Board followed its decision rendered on October 31, 1961, in *Middle South Broadcasting Co.*, 133 NLRB No. 1698. The primary employer in

---

<sup>9</sup> [footnote cont'd]

(ii)(B), while the word "services" is not used, the following language indicates the same differentiation between a primary employer who produces, processes or manufactures a tangible article, and one who does not; ". . . to cease using, selling, handling, transporting, or otherwise dealing in the products of any other producer, processor, or manufacturer, or to cease doing business with any other person, . . ." (Emphasis added.)

<sup>10</sup> It also requires one to regard the advertisers of those products, who either manufacture the article themselves or distribute articles manufactured by companies having no connection with the television station, as the "distributors" of articles "produced" by a television station.

that case was a radio broadcasting station. In turn, the decision in *Middle South Broadcasting* was based upon the Board's decision rendered on August 10, 1961 in *International Brotherhood of Teamsters, etc. (Lohman Sales Company)* 132 NLRB 901. There the primary employer was a wholesale distributor of cigarettes, cigars, other tobacco products, candy, and related products. The issue was whether a wholesale distributor is a producer of products within the meaning of the proviso.

In the *Lohman* case the Board first determined that, so far as human effort is concerned, labor is the prime requisite of one who produces.<sup>11</sup> The Board then reasoned that not only the actual manu [597] facturer, but also the wholesaler, adds "labor in the form of capital, enterprise, and service to the product he furnishes the retailers." "In this sense, therefore," the Board stated, "Lohman, as the other employers who 'handled' the raw materials of the product before him, is one of the producers of the cigarettes distributed by his customers. . . ."

In the Board's contemplation then, the "production" of cigarettes includes every phase of activity, beginning with the combination of tobacco seed, earth and water, and ending with the ready availability of cigarettes to the smoking public. Each employer in the process of production begins with what, to him, are raw materials, and "produces" what

---

<sup>11</sup> In reaching this conclusion the Board relied upon dictionary definitions, primarily upon a definition of "product" to be found in A. Meriam Webster, Webster's New Collegiate Dictionary, 1959, and an explanation of the term "production" contained in Black's Law Dictionary, Fourth Edition, West Publishing Co., 1951, pages 374-375. The latter definition is as follows:

"In political economy. The creation of objects which constitute wealth. The requisites of production are labor, capital, and the materials and motive forces afforded by nature. Of these, labor and the raw materials of the globe are primary and indispensable. Natural motive powers may be called in to the assistance of labor and are a help, but not an essential, of production. The remaining requisite, capital, is itself the product of labor. Its instrumentality in production is therefore, in reality, that of labor in an indirect shape. Mill, Political Economy; Wharton."

to him is a finished "product." The wholesale distributor (or in our case the television station) "handles" cigarettes which are not yet readily available to the members of the smoking public in the same sense as the manufacturer "handles" raw tobacco which has not yet become cigarettes. In this sense the wholesale distributor and the television station are producers of products capable of being distributed by their successors in the production process.

As we have indicated earlier in this opinion, the terms "product," "produce" and "production" may be construed this broadly if they are not found in a more restrictive context. But, as we have also indicated earlier, the context in which the words "produce" and "product" are found indicates that in using them Congress was referring to one kind of economic activity and its result rather than to all economic activity and its result.

The Board proceeds on the assumption that Congress intended "product" to encompass the results of all forms of economically productive labor. Yet it concedes that a television station's product is not advertising but the subject of the advertising. So long as the subject of the advertising is a tangible article these propositions need not lead to an incongruous result.

But if, instead of a tangible article, the subject of the television advertising is a service, such as banking or cleaning, an internal inconsistency at once appears.<sup>12</sup> It derives from the fact that while television advertising service, as such, is not to be regarded as a "product" under the proviso, because it is not capable of being distributed, a service being advertised on television is to be regarded as a "product," although it is equally incapable of being distributed.

---

<sup>12</sup> There is evidence in the case before us that the unions directed informational activity against one bank and one dry cleaning establishment. Since neither the bank nor the cleaners was found to be engaged in commerce or an industry affecting commerce, however, the union's activity with respect to them is not in issue here.



Thus, while the Board adopts a broad construction of the term "product" in order to obviate the incongruity of saying that a television advertising service is capable of being distributed, we find that, after all, the underlying difficulty has not been avoided. The Board is still saying that a service, though one being advertised rather than the television service itself, is a "product," although not capable of being distributed.

Only now the Board has involved itself in the additional difficulty of saying that a television station is a "producer" of banking and cleaning services which are "distributed" by banks and cleaners. If the capacity for distribution require- [598] ment is to be ignored it might as well be at the outset, with reference to television advertising service, thereby avoiding the futile involvements inherent in the Board's broad construction.

The Board expressed the view in *Lohman* that unless its concept were accepted, it must follow that "vast numbers of our working population produce nothing."<sup>13</sup> The weakness of this argument lies in the assumption that if, for the purposes of the proviso, the term "product" must be limited to a tangible article it must follow that even in a broad economic sense, only those engaged in manufacturing tangible articles are "producers."

The two frames of reference should not be confused. For the limited purposes of the proviso only those who deal with tangible articles are "producers," but in general economic theory, all who engage in useful labor, whether or not directly related to tangible articles, are "producers." In order to hold that a television station is not, within the meaning of the proviso, the producer of automobiles which

---

<sup>13</sup> Developing this idea, the Board said in *Lohman*:

"... Their thought, labor, or business enterprise is not a 'product.' We do not believe that the plain meaning of the words 'product' and 'produced' requires the Board to draw an uncertain line between those employers engaged essentially or only incidentally in the fabrication of products; between those employers who create a new product or embellish an old one; between products of the imagination and those that can be seen, touched, or smelled."



it advertises, it is not necessary to conclude that the engineers, announcers, advertising men and others employed by the station are not "productive." They perform a television advertising service, just as the employees of Lohman perform a distribution service. But since the fruit of their labor is not capable of physical distribution by others, it is not a "product" as that term is used in the proviso.

The Board believes that the legislative history indicates that the result reached in *Lohman, Middle South Broadcasting* and this case, is what Congress really intended.

We very much doubt that the statutory language of the publicity proviso is ambiguous with regard to the meaning of "produced," thereby warranting reference to legislative history. While this term is not defined in the Act, the context indicates to us that, in the proviso, Congress was referring to the activity of a primary employer in applying capital, labor and enterprise to effect the conversion of raw materials in his possession into a more finished tangible article.

In section 8(b)(4)(i)(ii)(B), which contains the only statutory reference to the kind of employers who can be the creators of "products," as that term is used in the Act, the words used are: "... the products of any other producer, processor, or manufacturer ..."<sup>14</sup> The words "processor" and "manufacturer" refer to persons engaged in a physical creative activity, and it is reasonable to believe that the word "producer" was used in the same sense. There is no reason to believe that "produced" was used in the proviso in any different sense than "producer" was used in section 8(b)(4)(i)(ii)(B).

But, assuming that resort to legislative history is appropriate, we believe it to be inconclusive as to the point under discussion.

It is true that this history indicates that some Senators and Congressmen expressed the view that inclusion of the

---

<sup>14</sup> The pertinent part of section 8(b)(4) is quoted in note 5.

publicity proviso was necessary because without it, section 8(b)(4)(ii)(B) might outlaw forms of publicity such as leaflets, radio broadcasts, and newspaper advertisements, thereby impinging upon free speech.<sup>15</sup> The Board argues, in effect, that there is no reason to believe [599] that Congress was less interested in preserving free speech where the primary employer is a distributor, or a radio or television operator, than when he is a manufacturer of tangible articles.

If all that Congress really had in mind in adding the publicity proviso was to implement, with respect to leaflets, broadcasting and newspapers, the free speech guarantee of the First Amendment, the proviso was not needed and would have to be regarded as surplusage. Section 8(c) of the Act, 29 U.S.C. § 158(c), already in effect, provided complete implementation of the First Amendment in this regard.<sup>16</sup> As intervenors in this case concede, section 8(c) is "no more than a restatement of the principle embodied in the First Amendment," quoting *NLRB v. LaSalle Steel Co.*, 7 Cir., 178 F.2d 829, 835.

Section 8(c), however, does not protect, under the guise of free speech, publicity activity which is associated with

---

<sup>15</sup> When the proposed 1959 amendment of section 8(b)(4) got to conference without such a proviso, Senator Kennedy and Representative Thompson expressed this concern. (105 Cong. Rec. 16591; II Legislative History of the Labor-Management Reporting and Disclosure Act of 1959 [Leg. Hist.] 1708). The proviso was thereafter added as a "clarification." (105 Cong. Rec. 18022; II Leg. Hist. 1712). In discussing the addition of this proviso, Senator Kennedy explained that, without the proviso, the amendment of section 8(b)(4) would have prohibited "the handing out of handbills or even taking out an advertisement in a newspaper." (105 Cong. Rec. 17720, 17898-17899; II Leg. Hist. 1388-1389, 1432). Senator Douglas and Representative Udall similarly expressed the view that the proviso was necessary to protect free speech. (105 Cong. Rec. 19904, 18135; II Leg. Hist. 1834, 1722).

<sup>16</sup> Section 8(c) reads:

"(c) The expressing of any views, argument, or opinion, or the dissemination thereof, whether in written, printed, graphic, or visual form, shall not constitute or be evidence of an unfair labor practice under any of the provisions of this subchapter, if such expression contains no threat of reprisal or force or promise of benefit."

coercion, since that subsection ends with the words, "... if such expression contains no threat of reprisal or force or promise of benefit." Thus if Congress desired to protect any kind of publicity which was associated with coercion, it was necessary to add statutory language which did not contain the limitations built into section 8(c). Apparently Congress did want to protect some publicity of this kind, and so solved the problem by adding the publicity proviso.<sup>17</sup>

This demonstrates, we think, that the meaning of "produced," as used in the publicity proviso, is not to be given an all-inclusive construction on the theory that Congress was trying to guarantee free speech. On the contrary, it suggests that since the publicity being protected by the proviso could be of a kind associated with threats, coercion, or restraint. Congress did not intend an expansive exception but chose words which would have limited application.

Had Congress intended to except publicity concerning primary employers whose own products were of an intangible nature not capable of "distribution," the [600] proviso

---

<sup>17</sup> The Board has itself held in *Lohman, Middle South Broadcasting Co.* and the case now before us, that the publicity proviso excepts certain publicity although coercion may be involved. The statutory authority for this is to be found in section 8(b)(4)(ii), quoted in note 5.

The Board said in *Lohman*, at page 904:

"... While such conduct otherwise might constitute restraint and coercion, we agree with the conclusion of the Trial Examiner that Respondent's hand-billing in this case was protected by the proviso to Section 8(b)(4)."

The Board reached a similar conclusion in its *Middle South Broadcasting Co.* decision, saying, at page 1705:

"... We also agree with his [Trial Examiner's] finding that, unless protected by the proviso to Section 8(b)(4), Respondent's circulation and distribution of the 'Do Not Patronize' leaflets urging a consumer boycott of secondary employers still advertising on WOGA, would constitute 'restraint or coercion' within the meaning of Section 8(b)(4)(ii)(B) and a violation of that section."

In the case now before us the Board, in its decision, makes reference, with approval, to its holding in *Lohman* that publicity activity may be protected by the publicity proviso, although such activity "might constitute restraint and coercion. . . ."

could have been much simpler than that which was enacted. It would have been sufficient to say that nothing contained in such paragraph shall be construed to prohibit publicity, other than picketing, "for the purpose of truthfully advising the public (including consumers) that *an establishment is operated*, or goods are produced or distributed, by an employer engaged in a labor dispute. . . ." (Emphasis supplied.)

In fact these identical words were proposed in a Senate Resolution, instructing the Senate conferees on S. 1555, offered in the Senate on August 28, 1959, by Senators Kennedy, McNamara, Morse and Randolph.<sup>18</sup> This resolution was not adopted.

Unlike the language proposed in the resolution which was not adopted, the statutory proviso does not include among designated primary employers, those who "operated" establishments or "distributed" goods. The only primary employers referred to in the enacted proviso are those who produce a product or products. This class of employers is further defined and restricted by the additional provision that the employer must be one who produces products capable of distribution.

It seems unlikely that an easy way of expanding the coverage of the proviso would have been rejected and detailed limiting provisions (which under the Board's reasoning become surplusage) would have been developed, if it had been intended that the proviso was to have the broad coverage given to it by the agency.<sup>19</sup>

---

<sup>18</sup> II Leg. Hist. 1383.

<sup>19</sup> We do not, however, agree with petitioner that significance is to be attached to the fact that, during the Congressional debates, the proviso as it was finally enacted was referred to only as one which would permit publicity concerning "goods" or "products." A close reading of the legislative history leads us to believe that reference to "goods" and "products" produced by non-union or struck "manufacturers" served only as an exemplification of the typical secondary boycott situation rather than as a conscious expression of Congressional purpose.

The foregoing considerations lead us to conclude that the publicity proviso which is a part of section 8(b)(4)(B) does not protect publicity to the effect that television service is rendered by a station with whom the labor organization has a primary dispute, which service is being utilized by other employers.

Intervenors argue, however, that even if the publicity proviso is inapplicable there are two other reasons why the Board order should be sustained. These are: (1) Section 8(b)(4)(ii)(B) relates only to union activity which tends to "threaten, coerce, or restrain," and the activity here in question was not of that kind; and (2) the union activity involved in this case is protected by the free speech and free press provisions of the First Amendment to the Federal Constitution.

The Board relied on neither of these grounds in entering its order here under review. With regard to the "coercion" argument, a determination is complicated by the fact that eight separate and distinct union actions are drawn into question. Some may be coercive and some may not.

In our view, the Board should make a determination as to the merits of these two additional arguments advanced by intervenors before this court is called upon to consider them.

The Board order under review is reversed and the cause is remanded to that agency for consideration, on the present record, with such augmentation thereof, if any, as it may deem appropriate, of the additional questions raised by intervenors, as noted above.

(Endorsed) Opinion Filed Nov. 9, 1962.

FRANK H. SCHMID, Clerk.



No. 20104

See Vol 5  
Add papers

---

**United States**  
**COURT OF APPEALS**  
**for the Ninth Circuit**

---

**TILLAMOOK CHEESE & DAIRY  
ASSOCIATION,**

*Plaintiff-Appellant,*

**v.**

**TILLAMOOK COUNTY CREAMERY  
ASSOCIATION, H. S. DIXON, GAYLORD  
P. SHIVELY, JOHN S. CRAVEN, JR., OTTO  
SCHILD and WARREN A. McMINIMEE,**

*Defendants-Appellees.*

---

**APPELLANT'S REPLY BRIEF**

---

*Upon Appeal from the Judgment of the United States  
District Court for the District of Oregon*

---

**ERNEST BONYHADI,  
BRUCE M. HALL,  
HARDY MYERS, JR.,**  
808 Executive Building,  
Portland, Oregon 97204,  
*Attorneys for Appellant.*

**BONYHADI & HALL,  
808 Executive Building,  
Portland, Oregon 97204,  
JACK, GOODWIN & ANICKER,**  
704 Main Street,  
Oregon City, Oregon,

**KENNETH S. KLARQUIST and  
JOSEPH B. SPARKMAN, JR.,**  
204 Board of Trade Building,  
Portland, Oregon 97204,  
*Of Counsel.*

FILED

10-20-65

FRANK H. SCHMIDT, CLERK





## INDEX

	Page
Preliminary Statement .....	1
Argument:	
I. Summary judgment was error with respect to the conspiracy charges against appellees	7
II. Summary judgment was error regarding ap- pellant's claims with respect to Warren Mc- Minimee .....	9
III. Summary judgment was error and particu- larly inappropriate in this case	9
Conclusion .....	12
Certificate of Counsel .....	14

## AUTHORITIES

Page

### TABLE OF CASES

Bergjans Farm Dairy Co. v. Sanitary Milk Producers (E.D. Mo. March 26, 1965), 1965 C.C.H. Trade Cases, Para. 71,466 .....	9
Cott Beverage Corp. v. Canada Dry Ginger Ale, Inc. (S.D. N.Y. 1956), 146 F. Supp. 300 [appeal dis- missed on other grounds, 243 F.2d 795] .....	9
Hartford-Empire Co. v. United States (1945), 323 U.S. 386, 89 L. Ed. 322 .....	
Poller v. Columbia Broadcasting System (1962), 368 U.S. 464, 7 L. Ed. 2d 458 .....	9, 10, 11
Sunkist Growers, et al. v. Winckler and Smith Citrus Products Co., et al. (1962), 370 U.S. 19, 8 L. Ed. 2d 305, reh. den. 370 U.S. 965, 8 L. Ed. 2d 834 .....	2, 3, 7, 9
Tillamook County Creamery Association v. Tilla- mook Cheese & Dairy Association (9 Cir. 1965), 345 F.2d 158 .....	12
United States v. Johns-Manville Corp. (E.D. Pa. 1964), 237 F. Supp. 885 .....	11, 12

### STATUTES

Sherman Act (15 U.S.C.) §§ 1 and 2 .....	referred to throughout this brief
---	-----------------------------------

### OTHER AUTHORITIES

Cox, 27 A.B.A. Antitrust § 72 .....	5
Kintner, <i>An Antitrust Primer</i> (MacMillan Company 1964), xiv .....	13

No. 20104

---

**United States**  
**COURT OF APPEALS**  
**for the Ninth Circuit**

---

TILLAMOOK CHEESE & DAIRY  
ASSOCIATION,

*Plaintiff-Appellant,*

v.

TILLAMOOK COUNTY CREAMERY  
ASSOCIATION, H. S. DIXON, GAYLORD  
P. SHIVELY, JOHN S. CRAVEN, JR., OTTO  
SCHILD and WARREN A. McMINIMEE,

*Defendants-Appellees.*

---

**APPELLANT'S REPLY BRIEF**

---

*Upon Appeal from the Judgment of the United States  
District Court for the District of Oregon*

---

**PRELIMINARY STATEMENT**

Appellant in its opening brief points out the law as applied to the record—the *whole* record, which appellant submits requires reversal of the summary judgments.

Appellant's opening brief stands unchallenged. Appellees' brief states no legal proposition or authority prompting the slightest change or shift in emphasis in appellant's argument here.

If there is but one conclusion to be drawn from reading appellees' brief and then re-reading appellant's opening brief, it is that there is not only one but there are many genuine issues of fact in dispute; these issues are unresolved by the test of trial—making plain the error of the trial court in allowing the summary judgments.

We note appellees' statement of the "Positions of the Parties" (Br. 5)<sup>1</sup> with some amazement.

Appellees argue the case was ripe for summary judgment; appellant firmly disagrees. Appellees ignore the record. Appellant *did* produce support for its allegations of conspiracy and attempted monopolization, which were far from "naked and conclusionary" (See R. 380-389). The allegations of the second amended complaint do not deserve appellees' characterization—"naked and conclusionary" (Br. 5). Let appellees be reminded that the trial court accepted the sufficiency of appellant's claim of attempted monopolization in denying summary judgment as to that claim. The only point which prompted the trial court, mistakenly we submit, to grant summary judgment as to the conspiracy portion of appellant's claim was the court's assumption that a third party, an "outsider" to the cooperative family, was required to be a part of the alleged conspiracy, taking the case past the hurdle thought to be posed by the so-called *Sunkist*<sup>2</sup> doc-

---

<sup>1</sup> As used in this brief, "Op. Br." refers to appellant's opening brief; "Br." refers to appellees' brief; "R." refers to the Clerk's record; and "Tr." refers to the Reporter's Transcript.

<sup>2</sup> *Sunkist Growers, et al. v. Winckler & Smith Citrus Products Co., et al.*, (1962) 370 U.S. 19, 8 L. Ed. 2d 305, reh. den., 370 U.S. 965, 8 L. Ed. 2d 834.

trine, and the court's failure to recognize the presence of an "outsider."

The court stated at one point: "We are still on our same course as to find out whether McMinimee or Cadonau [Alpenrose Dairy, Inc.] or both of them are that type of a separate and distinct legal entity from the co-op. If they are, then they would be capable of entering into a conspiracy with the co-op and would fall outside of the protection that is delineated in *Sunkist*." (Tr. 224)

Appellant is convinced and appellees admit<sup>3</sup> that Alpenrose Dairy, Inc. is a "separate and distinct legal entity from the co-op"; it is, therefore, capable of entering into a conspiracy with the co-op, consistent with the rationale of the *Sunkist* case.

Appellant in its opening brief has attempted to show that once this separate legal entity is established and, indeed, admitted, summary judgment is wholly inappropriate in the case at bar.

Appellant was precluded from any general pretrial discovery; discovery was limited by the trial court to establishing that Alpenrose Dairy, Inc. and Warren McMinimee were separate and distinct from the cooperative defendants—appellees. Therefore, it is incorrect to state that appellant has failed to produce any support for its allegations. Appellant's contentions about matters of fact clearly in dispute are set forth in the opening brief (Op. Br. 10-17). Appellees misstate appellant's position (Br. 5):

---

<sup>3</sup> "Alpenrose Dairy meets the threshold requirement of being an independent person, separate from TCCA." (Br. 9)



“Appellant’s position, in essence, is that summary judgment is inappropriate in an antitrust suit, and that by alleging antitrust violations in the language of the statute, which violations are denied by appellees, a genuine issue of material fact exists.”

This contention finds no support in appellant’s opening brief nor in the record or transcript in this case. What we do say is that “special exigencies of antitrust litigation are recognized by the Supreme Court as limiting advisability of summary judgment in antitrust cases” (Op. Br. 26). We say not only that “a genuine issue of material fact exists” but, indeed, that many such issues exist. It may be true that appellant’s complaint alleges antitrust violations in the language of the statute, but appellant has gone much further than *merely* alleging these violations in the language of the statute (R. 380-389, and also R. 330-375). The only thing to which a characterization of “naked and conclusionary” could be applied in this entire record are the denials of complicity in violations of the antitrust laws by some of the defendants and alleged co-conspirators (R. 110, 113, 117).

Such denials are not proof; they sharpen the issues which demand resolution by trial.

Appellees argue that this appeal presents two questions:

“1. Is not summary judgment dismissal of a conspiracy charge in an antitrust suit against an agricultural cooperative and its agents correct where plaintiff has been afforded every opportunity but has failed to show any ‘outside party’ as participating in the alleged conspiracy?” (Br. 5)

This is not the question presented by this appeal. The question rather is as stated in appellant's opening brief (Op. Br. 18-20); if we were to rephrase the question posed by appellees, based on the record and the transcript rather than wishful thinking, we could ask:

Is summary judgment with respect to a conspiracy charge in an antitrust suit against an agricultural cooperative and its agents correct where plaintiff has shown that an admittedly capable co-conspirator (Alpenrose Dairy, Inc.) is claimed to have participated in the alleged conspiracy (although denied by the alleged co-conspirator) when an attempted monopolization charge based on the same facts, but absent the legal requirement of an "outside party," is ordered to go to trial for resolution of genuine issues of material facts?<sup>4</sup>

We think it clear that a plaintiff need not prove an alleged conspiracy before trial; it merely has to show that a bona fide claim or contention is made that an admittedly "outside party" has participated to a greater or lesser extent in the alleged conspiracy. No pretrial discovery was undertaken with respect to the substantive charges of the conspiracy. Discovery was strictly limited to determining if the claimed co-conspirators were separate and apart from the co-op, TCCA (Tr. 205, 296, 211).

---

<sup>4</sup> That essentially the same facts support charges of violation of both Section 1 and Section 2 of the Sherman Act is an accepted standard familiar to the antitrust bar:

"The antitrust indictment or complaint with which we are all familiar is one that charges a violation of both sections and in doing so usually relies upon essentially the same set of facts to support both charges." Hugh B. Cox, Esq., of Covington & Burling, in his paper to the Spring Meeting of the Section of Antitrust Law, A.B.A., in Washington D. C., April 8, 1965 (27 A.B.A. Antitrust Section 72).

The second question presented by appellees' brief (Br. 6) finds no basis in law; its premise is a non-sequitur. If we assume that Alpenrose Dairy, Inc. is a separate and distinct legal entity, as is admitted by appellees (Br. 9, R. 398), then the only question to be answered (Op. Br. 19) is whether the mere fact that a defendant is a lawyer relieves him from the obligation to abide by the antitrust laws of this country. That Mr. McMinimee may have been more than merely the lawyer for the other appellees appeared to be recognized by the trial court's comment before Mr. McMinimee's examination on deposition and in limiting the scope of that deposition:

"So I am not interested in going into any transactions between Mr. McMinimee and the defendant, because I am willing to accept that they are in bed together and they own each other and one is the alter ego of the other. Now, let's find out in what entity he represents that puts him in the category of being a legal entity to join as a conspirator with one or more of the defendants" (Tr. 231).

Appellees' summary of argument and argument (Br. 6-22) ignore most of the record and transcript. To say, for example, that "the relationship between Alpenrose and TCCA was fully developed in the Cadonau and Dixon affidavits and by Mr. Cadonau's testimony" (Br. 9) stands like an Alice-in-Wonderland-proposition, in view of the whole record.

Appellees ask the Court to accept as the gospel truth the self-serving declarations and affidavits of their partisans (Br. 9-10): the affidavits of Cadonau and Dixon

(R. 110, 113) and Cadonau's testimony (Tr. 268-307). To the extent that contentions are made by the appellant's witnesses, these are characterized as "vague opinions and conclusions." These, however, were sufficient to compel the trial judge to deny summary judgment sought by appellees with respect to the monopolization charge.

In short, appellees' argument is really no answer to the opening brief which asks the summary judgments be reversed based on the whole record and the applicable law.

## ARGUMENT

### I. Summary judgment was error with respect to the conspiracy charges against appellees.

The authorities cited by appellees in their brief do not support their contention that summary judgment is proper on the basis of the record in this case. This particular part of appellees' argument (Br. 7-12) cites only one case, the *Sunkist*<sup>5</sup> case, as authority for the trial court's opinion of August 6, 1964 (R. 85) with respect to the original complaint (R. 1), not the second amended complaint (R. 380). Appellees did not even attempt to answer the numerous authorities cited by appellant, or take issue with appellant's detailed discussion of the *Sunkist* case (Op. Br. 3, 21, 22, 27, 29, 37, 39).<sup>6</sup>

---

<sup>5</sup> Note 2, p. 2 *supra*.

<sup>6</sup> These page references to the opening brief refer to the pages in the opening brief where the *Sunkist* case was cited or discussed by appellant.

Appellees' argument that ". . . Mr. McMinimee and Alpenrose Dairy are not now, and never have been, involved in any violations of the antitrust laws, and are not capable co-conspirators" ignores much of the record,<sup>7</sup> and also it is an inappropriate statement in terms of the legal premise in the case of a summary judgment question.

We make the latter point because appellant did not need to show that an "outside person" did in fact conspire to violate the antitrust laws; all we had to show was that we have a *prima facie* case of a conspiracy, not necessarily to violate the antitrust laws, but which conspiracy would have effected a violation of the antitrust laws. Once a *prima facie* claim is established, by verified complaint, affidavits and testimony, then denied by the accused appellees and their friends, such as Alpenrose Dairy, Inc., a genuine issue of fact exists and a trial rather than a summary disposition is indicated.

The presence of a capable "outside person" is admitted, as we pointed out before (Br. 9).<sup>8</sup>

Appellant submits, as we argued in our opening brief,

---

<sup>7</sup> R. 308, Br. 9.

<sup>8</sup> At R. 398 appellees state, in a legal memorandum submitted to the trial court ". . . there is no question that Alpenrose Dairy, Inc. is distinct from and not part of the TCCA organization. The sole question, therefore, is whether Alpenrose Dairy, acting by and through Carl H. Cadonau, was, as *far as plaintiff is concerned*, anything more than a mere customer of TCCA." (Emphasis supplied). Appellees pose the question much more candidly and correctly in their memorandum to the trial court than anywhere in their brief to this court.

". . . as far as plaintiff is concerned" Alpenrose Dairy, acting by and through Carl H. Cadonau, was indeed "more than a mere customer of TCCA"; it is an alleged co-conspirator.



that summary judgment as to the conspiracy charge was error, applying the relevant authority to the record in this case.

## **II. Summary judgment was error regarding appellant's claims with respect to Warren McMinimee.**

Appellees' argument on this point is brief. Beyond this, it has no merit. No authorities are cited by appellees in support of their argument that summary judgment in their view was proper with respect to defendant Mr. McMinimee (Br. 13). We assume they found none. No attempt is made to respond to the argument of appellant (Op. Br. 33-55) and to authorities cited by us in support thereof,<sup>9</sup> with the sole exception of the *Poller* case, and that in another part of their brief (Br. 17-21).

## **III. Summary judgment was error and particularly inappropriate in this case.**

Appellees argue that summary judgment is particularly appropriate in the present case, from Page 13 through Page 22 of their brief. This is the only part of the brief where any judicial authority is cited other than the *Sunkist* case. There is practically no pretense of relating the authorities and the argument to the record.

---

<sup>9</sup> Op. Br. 33-35: *Cott Beverage Corp. v. Canada Dry Ginger Ale, Inc.* (S.D. N.Y. 1956) 146 F. Supp. 300 [appeal dismissed on other grounds, 243 F.2d 795], 1956 C.C.H. Trade Cases, Para. 65,531; *Poller v. Columbia Broadcasting System*, (1962) 368 U.S. 464, 7 L. Ed. 2d 458; *Bergjans Farm Dairy Co. v. Sanitary Milk Producers*, (D.C. E.D. Mo., 1965) 1965 C.C.H. Trade Cases, para. 71,466; *Hartford-Empire Co. v. United States*, (1945) 323 U.S. 386, 89 L. Ed. 322.



The only reference to the record is to "R. 1, 92, 380" in one footnote (Br. 16)<sup>10</sup> and to "R. 108" in another footnote (Br. 19).<sup>11</sup>

It is quite astounding to read appellees' contention that a mere reading of the complaints is sufficient to show if the plaintiff has a claim or if summary judgment lies. If this were the case, it would expedite and enhance efficiency in Federal litigation, although, we suggest, at the expense of the fairness and justice.

Appellees cite 20 cases as "authority" in this particular portion of the argument. None relates to the record and the transcript.

The references to the transcript which do appear in this portion of the argument are limited to the self-serving declarations of Mr. McMinimee, one of the appellees, Mr. Cadonau, an officer of Alpenrose Dairy, Inc., an alleged co-conspirator,<sup>12</sup> a reference to the trial judge's discussion with counsel,<sup>13</sup> as well as references to statements of counsel<sup>14</sup> which are taken out of context and thus distorted.

Appellees argue that appellant relied on *Poller v. Columbia Broadcasting System*, supra, "as barring summary judgment in antitrust cases" (Br. 17), referring to appellant's opening brief, pp. 25-27, 34, 35.

---

<sup>10</sup> R. 1 refers to the original complaint, R. 92 identifies the first amended complaint, R. 380 the second amended complaint.

<sup>11</sup> R. 108 is the appellees' motion for summary judgment relative to the first amended complaint.

<sup>12</sup> Note 54, Br. 19.

<sup>13</sup> Note 53, Br. 19.

<sup>14</sup> Note 56 and 57, Br. 20.

Appellees distort our position by ascribing to us the sort of wishful oversimplification which marks appellees' brief. We cannot and did not assert the *Poller* case, or indeed any case, as *barring* summary judgment in anti-trust cases.

No such sweeping authority is available to us.

We did contend, however, and so *Poller* holds, that the advisability of summary judgment in antitrust cases is limited, and we contend that in the light of this admonition, summary judgment was not proper and advisable in the case at bar; it should be reversed.

One case cited by appellees in support of their position<sup>15</sup> is discussed in the last footnote of appellees' brief (Br. 22, Note 58). Appellees quote an excerpt from that decision which distinguishes *Poller* because, so the court states, in *U. S. v. Johns-Manville*, the plaintiff (the Government) relied chiefly on the allegations in its pleadings, and the record consisted of testimony given by witnesses during an earlier criminal trial lasting over four months, who were cross-examined and had their demeanor appraised by the trial judge.

Appellees then argue:

"In the present situation, two of the defendants, TCCA and TC & DA, have recently been involved in a trial before the same judge. In that trial, which involved ownership and use of a trademark, the relationships between the parties was developed in

---

<sup>15</sup> *United States v. Johns-Manville Corp.* (E.D. Pa. 1964) 237 F. Supp. 885.

the record. The earlier case is reported at 143 USPQ 12." (Br. 22)<sup>16</sup>

We reply: Nonsense.

1. In *Johns-Manville*, the previous criminal trial related to the same facts as the later civil antitrust case. Not so in the case at bar.

2. In that criminal trial, the case was resolved against the Government and for the defendant, Johns-Manville Corp. In the present case, the preceding trademark case was resolved in favor of TC & DA, the appellant here, and against TCCA, an appellee, not only by the trial court, but by this court on appeal; if there is weight to be given to implications arising out of prior litigation between the parties, we would call the court's attention not only to the results of that case,<sup>17</sup> but to specific findings of the trial court which withstood the test of appeal. The trial court's memorandum decision in that case is found in this record (R. 13-38) as was noted in the opening brief (Op. Br. 4).

## CONCLUSION

Appellees chide us by suggesting this case be, in effect, thrown in the ash can on the basis of a mere reading of the complaints because:

"This case is just another expression of the bit-

---

<sup>16</sup> Appellees mistakenly refer to TC & DA as a defendant here; TC & DA is the plaintiff-appellant, —the "we" in this brief. TCCA is one of the defendants-appellees.

<sup>17</sup> Reported not only in the USPQ (as cited in Br. 22, Note 58, though not listed under "authorities" Br. ii-iii), but also at 345 F.2d 158 (*Tillamook County Creamery Association v. Tillamook Cheese & Dairy Association*, 9 Cir. 1965).

ter acrimony existing between the parties which has manifested itself in a series of lawsuits on various issues in the state and federal courts.

“Appellant is an admitted newcomer in the marketing of dairy products and has suffered the problems and frustrations of anyone launching itself into a highly competitive market with no prior experience. Appellant seeks to blame appellees for all its problems and to cloak its mistakes and failures as part of a sinister plot on the part of appellees to destroy appellant’s business.” (Br. 16)

True, the parties have been engaged in a series of lawsuits in various courts. Regrettable as this is, it is no justification for summary judgment.

Appellant was a newcomer in the marketing of dairy products, since in the marketing field, appellant TCCA has previously been appellant’s agent. Appellant has suffered frustrations and indeed substantial damages, and by this suit seeks to establish that, in large measure, these damages may be laid at the door of the appellees.

“A precious part of our freedom is the freedom to enter a market, the freedom to win a place there through strenuous competitive effort, the freedom to buy and sell without restraints imposed by others. It is these freedoms that the antitrust laws protect.”<sup>18</sup>

The appellant is fighting to secure its economic freedom in the market place, to secure its freedom to buy

---

<sup>18</sup> Earl W. Kintner, former Chairman and General Counsel of the Federal Trade Commission, Prologue to *An Antitrust Primer*, at Page xiv (The Macmillan Company, 1964).

and sell without restraints appellant claims have been imposed by the appellees to its damage.

This freedom of appellant can only be protected and effectively secured by a resolution of the questions here raised upon a full trial.

In this reply brief, as in our opening brief, we respectfully ask that the summary judgments be reversed and the cause be remanded for trial.

Dated: October 19, 1965.

ERNEST BONYHADI,  
BRUCE M. HALL,  
HARDY MYERS, JR.,

Attorneys for Plaintiff-Appellant

BONYHADI & HALL,  
JACK, GOODWIN & ANICKER,  
KENNETH S. KLARQUIST and  
JOSEPH B. SPARKMAN, JR.,

Of Counsel.

#### CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

ERNEST BONYHADI

**United States**  
**COURT OF APPEALS**  
**for the Ninth Circuit**

---

TILLAMOOK CHEESE & DAIRY  
ASSOCIATION,

*Plaintiff-Appellant,*

v.

TILLAMOOK COUNTY CREAMERY  
ASSOCIATION, H. S. DIXON, GAYLORD  
P. SHIVELY, JOHN S. CRAVEN, JR., OTTO  
SCHILD and WARREN A. McMINIMEE,

*Defendants-Appellees.*

---

**BRIEF FOR APPELLEES**

---

*Upon Appeal from the Judgment of the United States  
District Court for the District of Oregon*

---

J. PIERRE KOLISCH,  
1004 Standard Plaza,  
Portland, Oregon 97204,

*Attorney for* FRANK H. SCHMID, CLE  
*Defendants-Appellees.*

KOLISCH & HARTWELL,  
JON M. DICKINSON,  
1004 Standard Plaza,  
Portland, Oregon 97204,  
*Of Counsel.*





# INDEX

	Page
Counter Statement of Case .....	1
A. The Parties .....	1
B. The Litigation to Date .....	3
C. Positions of the Parties .....	5
Questions Presented .....	5
Summary of Argument .....	6
Argument .....	7
I. Summary Judgment was Properly Granted With Respect To the Conspiracy Charges Against All Appellees .....	7
II. Summary Judgment was Properly Granted With Respect To the Attempt To Monopolize Charge Against Warren McMinimee.....	13
III. Summary Judgment is Particularly Appro- priate in the Present Case .....	13
Conclusion .....	22
Certificate of Counsel .....	23

## TABLE OF AUTHORITIES

Page

## CASES

Arzee Supply Corp. of Conn. v. Ruberoid Co., D.C. Conn., 1963, 222 F. Supp. 237 .....	17
Becker-Lehman, Inc. v. Firestone Tire and Rubber Co., D.C. Md., 1959, 202 F. Supp. 514 .....	17
Bond Distributing Co. v. Carling Brewing Company, D.C. D. Md., 1963, 32 F.R.D. 409, aff'd, 4 Cir., 325 F.2d 158 .....	20
Byrnes v. Mutual Life Insurance Co. of New York, 9 Cir., 1954, 217 F.2d 497 .....	15
Fiumara v. Texaco, Inc., D.C. E. D. Pa., 1962, 204 F. Supp. 544, aff'd, 3 Cir., 310 F.2d 737 .....	21
Gold Fuel Service, Inc. v. Esso Standard Oil Co., D.C. D. N.J., 1962, 195 F. Supp. 85, aff'd, 3 Cir., 306 F.2d 61 .....	21
Koepke v. Fontecchio, 9 Cir., 1949, 177 F.2d 125 .....	15
Krug v. International Telephone & Telegraph, D.C. N.J., 1956, 142 F. Supp. 230 .....	17
Lindsey v. Leavy et al, 9 Cir., 1945, 149 F.2d 899 .....	15
MacKay v. American Potash & Chemical Co., 9 Cir., 1959, 268 F.2d 512 .....	15
Norton v. McShane, 5 Cir., 1964, 332 F.2d 855 .....	16
Poller v. Columbia Broadcasting Co., 1962, 368 U.S. 464, 7 L. Ed. 2d 458 .....	17, 18, 19, 20, 21
Pugliano v. Staziak, D.C.W.D. Pa., 1964, 231 F. Supp. 347 .....	16
Savon Gas Stations v. Shell, D.C. D. Md., 1962, 203 F. Supp. 529, aff'd, 4 Cir., 309 F.2d 306 .....	20
Scolnick v. Lefkowitz, 2 Cir., 1964, 329 F.2d 716 .....	16

## TABLE OF AUTHORITIES (Cont.)

	Page
State of Maryland v. U. S., D.C.E.D. Pa., 1963, 221 F. Supp. 740 .....	16
Sunkist Growers et al v. Winckler & Smith Citrus Products Co. et al, 1962, 370 U.S. 19, 8 L. Ed 2d 305 .....	7, 11, 12
The White Motor Co. v. U. S., 1963, 372 U.S. 253, 9 L. Ed. 2d 738 .....	18
United States v. Johns-Manville Corp., D.C.E.D. Pa., 1964, 237 F. Supp. 885 .....	21, 22
Weyerhaeuser v. Gershman, 2 Cir., 1963, 324 F.2d 163 .....	16

## STATUTES

15 U.S.C. § 1 .....	1, 3, 17, 22
15 U.S.C. § 2 .....	1, 3, 17, 22
7 U.S.C. § 291 .....	12
Federal Rules of Civil Procedure:	
Rule 56 .....	15, 18
Rule 56(b) .....	13
Rule 56(c) .....	14
Rule 56(e) .....	14, 15, 16



No. 20104

---

**United States**  
**COURT OF APPEALS**  
**for the Ninth Circuit**

---

TILLAMOOK CHEESE & DAIRY  
ASSOCIATION,

*Plaintiff-Appellant,*

v.

TILLAMOOK COUNTY CREAMERY  
ASSOCIATION, H. S. DIXON, GAYLORD  
P. SHIVELY, JOHN S. CRAVEN, JR., OTTO  
SCHILD and WARREN A. McMINIMEE,

*Defendants-Appellees.*

---

**BRIEF FOR APPELLEES**

---

*Upon Appeal from the Judgment of the United States  
District Court for the District of Oregon*

---

**COUNTER STATEMENT OF CASE**

**A. The Parties.**

This is an action for alleged violations of Sections 1 and 2 of the Sherman Act (15 U.S.C. §§ 1 and 2). Plaintiff-appellant (TC&DA) is an agricultural cooperative engaged in the production and marketing of dairy prod-



ucts. Defendants-appellees are an agricultural marketing cooperative (TCCA), certain of its officers (H. S. Dixon and John S. Craven, Jr.), its general counsel (Warren A. McMinimee), and certain officers of other agricultural producing cooperatives which are members of TCCA (Gaylord P. Shively and Otto Schild).

Appellee TCCA is a federated cooperative which is the exclusive marketing agent for its producer-member cooperatives, each of which comprises numerous individual patron-producers of dairy products. TCCA has been the exclusive marketing agent for its members since 1917. For many years, prior to September, 1963, appellant and its predecessors were members of TCCA. In September, 1963, appellant voluntarily withdrew from membership, and shortly thereafter launched for the first time its own program for marketing dairy products.<sup>1</sup> Several months after its entry as a marketer, in May, 1964, appellant commenced the present action.

For a number of years, Mr. McMinimee has been employed by TCCA as its general counsel,<sup>2</sup> and prior to his inclusion as a party defendant, he was actively representing TCCA in this suit, as well as in other suits between TCCA, TC&DA and appellant, Red Clover. He was also representing some of the individual defendants. Carl Cadonau is general manager of Alpenrose Dairy,

---

<sup>1</sup> Appellant's Opening Brief, p. 16, where it admits that it is a "fledgling" in its marketing activities. (The following designations will be used throughout this brief: "R." to designate the Clerk's record and "Tr." to designate the Reporter's transcript).

<sup>2</sup> R. 115, 117; Tr. 239.

Inc. which has been and still is an important milk-purchasing customer of TCCA.<sup>3</sup>

## **B. The Litigation to Date.**

To date, the litigation has involved the filing of three complaints: a first complaint which charged appellees, absent Warren A. McMinimee, with conspiracies under Sections 1 and 2 of the Sherman Act,<sup>4</sup> and which was dismissed in August, 1964, for failure to name capable co-conspirators;<sup>5</sup> a first amended complaint which included the Section 1 conspiracy charges of the first complaint, but which added Warren A. McMinimee as a defendant and co-conspirator, and Carl Cadonau as a co-conspirator, and which further altered the claim under Section 2 of the Sherman Act from conspiracy to attempted monopoly;<sup>6</sup> and a second amended complaint which substituted Alpenrose Dairy, Inc. for Carl Cadonau as a co-conspirator.<sup>7</sup> In all three of the complaints, the alleged violations are recited only in the conclusory language of the statute.

The motion to dismiss the first complaint was granted with leave to add appropriate parties.<sup>8</sup> Thereafter, appellant filed a first amended complaint,<sup>9</sup> and then a second amended complaint.<sup>10</sup> Appellees filed motions for

---

<sup>3</sup> R. 111; R. 115; Tr. 269.

<sup>4</sup> R. 1.

<sup>5</sup> R. 85; R. 91.

<sup>6</sup> R. 92.

<sup>7</sup> R. 380.

<sup>8</sup> R. 91.

<sup>9</sup> R. 92.

<sup>10</sup> R. 380.

summary judgment directed, respectively, against appellant's first and second amended complaints.<sup>11</sup> In support of their motions they presented affidavits of H. S. Dixon,<sup>12</sup> Carl Cadonau,<sup>13</sup> and Warren McMinimee.<sup>14</sup> In opposition to the motions appellant presented numerous affidavits,<sup>15</sup> submitted about 260 detailed interrogatories,<sup>16</sup> 69 of which have been fully answered,<sup>17</sup> conducted 8 depositions,<sup>18</sup> and took the testimony of Warren McMinimee and Carl Cadonau in open court.<sup>19</sup> The court held two hearings with respect to appellees' motions against the complaints. The court partially granted appellees' motions against the second amended complaint, dismissing the conspiracy charges against all ap-

---

<sup>11</sup> R. 108, 391, 411.

<sup>12</sup> R. 113.

<sup>13</sup> R. 110.

<sup>14</sup> R. 117.

<sup>15</sup> Affidavits of: George Milne, September 30, 1964, R. 139; Hans Leuthold, November 24, 1964, R. 330; Del Mayer, November 24, 1964, R. 338; Joe Donaldson, November 20, 1964, R. 340; Glenn Johnston, November 20, 1964, R. 343; Floyd Woodward, November 20, 1964, R. 345; Vern Lucas, November 20, 1964, R. 346; George Milne, November 23, 1964, R. 349; Barbara Milne, November 20, 1964, R. 362; Clem Hurliman, November 21, 1964, R. 367; Basil Tone, November 20, 1964, R. 372; and Evelyn Pallin, November 20, 1964, R. 374.

<sup>16</sup> Interrogatories to Warren A. McMinimee, R. 143; Interrogatories to TCCA, R. 156; Interrogatories to Otto Schild, R. 161; Interrogatories to Gaylord P. Shively, R. 167; and Interrogatories to John S. Craven, Jr., R. 206.

<sup>17</sup> Answers of Warren A. McMinimee, R. 298; Answers of Otto Schild, R. 316; Answers of Gaylord P. Shively, R. 321; Answers of John S. Craven, Jr., R. 326.

<sup>18</sup> Tr. 232, 233; Depositions of: J. E. "Bud" Davis, Arnold Walker, Virgil Chadawick, Karl T. Zweifel, Carl L. Hurliman, Gene Widmer, Millard Bailey, and Rudolph J. Fenk, all taken on October 13, 1964.

<sup>19</sup> Appellant's counsel referred to the appearances of McMinimee, Tr. 239-268, and Cadonau, Tr. 268-307, as appearances of "court's witnesses", Tr. 230.

pellees (first claim),<sup>20</sup> and dismissing the attempted monopoly charges against appellee Warren McMinimee (second claim).<sup>21</sup> The present appeal is taken from both summary judgments of dismissal.<sup>22</sup>

### C. Positions of the Parties.

Appellees' position is that the case was ripe for summary judgment for the reason that although appellant was afforded every opportunity, through extensive discovery proceedings and court hearings, to support its naked conclusory allegations of conspiracy and attempted monopoly, it failed to produce any support therefor.

Appellant's position, in essence, is that summary judgment is inappropriate in an antitrust suit, and that by alleging anti-trust violations in the language of the statute, which violations are denied by appellees, a genuine issue of material fact exists.

## QUESTIONS PRESENTED

1. Is not summary judgment dismissal of a conspiracy charge in an antitrust suit against an agricultural cooperative and its agents correct where plaintiff has been afforded every opportunity but has failed to show any "outside party" as participating in the alleged conspiracy?

---

<sup>20</sup> Order on Defendants' Motion for Summary Judgment, R. 409; Amended Order on Defendants' Motion for Summary Judgment and Summary Judgment, R. 437.

<sup>21</sup> R. 441.

<sup>22</sup> Notice of Appeal, R. 432; Amended and Supplemental Notice of Appeal, R. 439.

2. Is not summary judgment dismissal of an attempt to monopolize charge against a lawyer in an antitrust suit against the lawyer and his client correct where plaintiff has been afforded every opportunity but has failed to show that the lawyer has attempted to monopolize or has conducted himself other than as a legal adviser, and where undisputed facts show that the attorney-client relationship between him and his client has always been maintained?

### SUMMARY OF ARGUMENT

The conspiracy charges against all appellees were properly dismissed by summary judgment because, despite three opportunities to do so, appellant was unable to show that there was a capable "outside person" with which the agricultural cooperative, TCCA, conspired to violate the antitrust laws.

Summary judgment was properly granted with respect to the attempt to monopolize charge against TCCA's general counsel, Warren McMinimee, because appellant was unable to show that Warren McMinimee acted other than as an attorney in all his dealings with the other appellees.

Partial summary judgment was particularly appropriate in this case where exhaustive discovery, including numerous depositions, interrogatories and testimony of key witnesses before the court, failed to produce any material fact dispute.



## ARGUMENT

### I. Summary Judgment was Properly Granted With Respect To the Conspiracy Charges Against All Appellees.

The trial court correctly found in its opinion of August 6, 1964,<sup>23</sup> that the conspiracy charges against certain of the appellees should be dismissed under authority of *Sunkist Growers et al v. Winckler & Smith Citrus Products Co., et al*, 1962, 370 U.S. 19, 8 L. Ed. 2d 305 because there were no "outside persons" named with which appellee TCCA, an agricultural cooperative, could have conspired. Appellant sought to remedy this by amendments to the complaint adding the name of TCCA's general counsel, Warren McMinimee, as a defendant and an alleged co-conspirator and a customer of TCCA, Alpenrose Dairy, Inc., as another alleged co-conspirator, but not as a defendant.

In order to determine the possible involvement of Mr. McMinimee and Alpenrose in the alleged antitrust violations, and whether they were "outside persons" who conspired with the other appellees or attempted to monopolize commerce, appellant was permitted the extensive pre-trial discovery previously mentioned.<sup>24</sup>

---

<sup>23</sup> R. 85.

<sup>24</sup> In addition to discovery, appellant had the benefit of much live testimony. At a hearing on appellant's motion for preliminary injunction (Tr. Vol. II) in answer to a question from the Court (Tr. 34), appellant's counsel stated that appellant was treating the Minnesota cheese situation as an incident of the alleged antitrust conspiracy of appellees, and thereafter examined in open court appellee Dixon (Tr. 36-90, 154-155), Roger Higgins, appellant's CPA (Tr. 91-93), Allen Thomas, an employee of appellant TC&DA (Tr. 94-115), George Milne, president of appellant (Tr.



The sum and substance of appellant's exhaustive investigation is that Mr. McMinimee and Alpenrose Dairy are not now, and never have been, involved in any violations of the antitrust laws, and are not capable co-conspirators.

In the case of Mr. McMinimee, the record shows that in addition to submitting an affidavit<sup>25</sup> and answering interrogatories,<sup>26</sup> he testified in court concerning his relationship and activities with respect to the other appellees.<sup>27</sup> All of that established that he is a lawyer who has been general counsel to TCCA since 1958 and has represented certain others of the individual appellees as an attorney.<sup>28</sup> His thorough answers to interrogatories showed clearly the attorney-client relationship which he maintained with TCCA and others, and this was in no way refuted by the searching examination of appellant's counsel.<sup>29</sup>

Appellant's affidavits of Basil Tone, Clem Hurliman, Floyd Woodward, Vern Lucas, Barbara Milne, Glen Johnston, Del Mayer, Joe Donaldson and George Milne,<sup>30</sup> which supposedly show "specific facts" to the con-

---

116-130), Basil Tone, president of appellant Red Clover Creamery Association (Tr. 131-136), Hans Leuthold, a member of the Board of TC&DA (Tr. 137-143), and Robert Kerr, an attorney for TC&DA specializing in cooperative corporate affairs (Tr. 143-153). The examination of these witnesses was not limited to Minnesota cheese, but covered a wide range of subjects which would have revealed illegal conduct on the part of appellees, had there been any.

<sup>25</sup> R. 117.

<sup>26</sup> R. 298.

<sup>27</sup> Tr. 239-268.

<sup>28</sup> Tr. 239.

<sup>29</sup> See footnote 27 above.

<sup>30</sup> See footnote 15 above.

trary, say nothing more than this: that Warren McMinimee went to numerous meetings, some of which were attended by a majority of the board members of TCCA; that he conferred with the board members at those meetings; and that occasionally he expressed his opinions on matters concerning TCCA. Plainly, these actions do not support appellant's position that Mr. McMinimee is an *independent* and *outside* party who has entered into a conspiracy. No amount of characterization of his conduct as wrongful and sinister can avoid the fact that appellant has failed to show facts supporting its conclusion that his conduct has been inconsistent with his duties as an attorney for TCCA.

Nor are there facts to support charges of conspiracy between TCCA and Alpenrose Dairy. Again, as with Mr. McMinimee, it is the characterizations of facts which are in dispute, not the facts themselves. Alpenrose Dairy meets the threshold requirement of being an independent person, separate from TCCA. The sole question therefore is whether appellant has produced facts to challenge appellees' clear showing that Alpenrose Dairy, acting by and through Carl Cadonau, is nothing more than a mere customer of TCCA.

The relationship between Alpenrose and TCCA was fully developed in the Cadonau and Dixon affidavits<sup>31</sup> and by Mr. Cadonau's testimony.<sup>32</sup> The undisputed facts show that Alpenrose is a customer of TCCA, that it purchases only a part of its milk requirements from

---

<sup>31</sup> R. 110, 113.

<sup>32</sup> Tr. 268-307.

TCCA, that it has had a good working relationship with TCCA through Mr. Dixon, and that there has never been any relationship between Alpenrose and TCCA different from supplier-purchaser.<sup>33</sup>

In opposition to these facts, appellant has come forth with vague opinions and conclusions. In his first affidavit, George Milne says that he is "informed," and therefore "believes" "\* \* \* that Mr. Cadonau participated directly or indirectly in the agreement, combination or conspiracy which is the subject of plaintiff's complaint \* \* \*",<sup>34</sup> and that Cadonau made it "clear" that TCCA would lose Alpenrose's business if Dixon were discharged.<sup>35</sup> What he refers to by this latter assertion is a letter sent by Cadonau to TCCA.<sup>36</sup> The letter, which shows nothing more than an expression of satisfaction from a customer, clearly does not help to support a charge of antitrust conspiracy. Mr. Milne's beliefs and conclusions, worded in the vague language of the Sherman Act, are certainly not "facts."

The sum and substance of the Leuthold affidavit is that Alpenrose liked doing business with TCCA.<sup>37</sup> The affidavits of Del Mayer and Vern Lucas tell nothing more.<sup>38</sup>

Legal conclusions, innuendos, assertions and *ad hominem* attacks in the affidavits are appellant's rebuttal

---

<sup>33</sup> R. 111-112, 115; Tr. 269-271.

<sup>34</sup> R. 140.

<sup>35</sup> R. 141.

<sup>36</sup> R. 337.

<sup>37</sup> R. 330-336.

<sup>38</sup> R. 338, 346.

“facts.” Out of a normal customer relationship, appellant has sought to fabricate an illegal conspiracy to restrain trade. The lack of supporting facts suggests strongly that this has been done solely to make formal compliance with the requirement of alleging outside parties as co-conspirators with TCCA, and perhaps also to embarrass TCCA by involving one of its good customers, Alpenrose, in a lawsuit.

In order to make the conspiracy charge stand, appellant had to show that there was at least one capable co-conspirator, i.e., someone outside the TCCA cooperative family who did engage in some illegal conduct. Appellant picked Mr. McMinimee and Alpenrose for this role, but was unable to develop any facts in support of that position despite a solemn representation to the court that Mr. McMinimee acted other than as a lawyer, and that he engaged in an illegal conspiracy with his client. The court felt that its hands were tied in view of counsel’s representation, and permitted counsel the opportunity he requested by way of depositions, hearings and briefs to try and develop facts in support of the allegations against Mr. McMinimee.<sup>39</sup>

The *Sunkist* case, *supra*, controls the situation and appellant doesn’t avoid it simply by naming as a co-conspirator an admittedly outside party such as Alpenrose, when in fact there is no showing of illegal conduct involving that party. Appellant’s case is built on conclusory assertions which it argues should be accepted as true despite the opportunity but complete failure to

---

<sup>39</sup> Tr. 216.

show supporting facts. Mere bold assertions that TCCA has not operated as a lawful cooperative<sup>40</sup> do not get around the *Sunkist* case any more than does picking the name of an outside party such as Alpenrose. If it were otherwise, *Sunkist* would be meaningless in that it could be circumscribed simply by an allegation that a cooperative defendant is not legally carrying out legitimate objectives of the association.<sup>41</sup>

---

<sup>40</sup> Appellant's Opening Brief, pp. 31-33.

<sup>41</sup> Another attempt by appellant to confuse the issue and seek to distinguish from *Sunkist* appears on page 28, footnote 15 of Appellant's Opening Brief where it is suggested that TCCA does not qualify as a Capper-Volstead cooperative. That act provides in pertinent part, 7 U.S.C. § 291:

"Persons engaged in the production of agricultural products as farmers, planters, ranchmen, dairymen, nut or fruit growers may act together in association, corporate or otherwise, with or without capital stock, in collectively processing, preparing for market, handling, and marketing in interstate and foreign commerce, such products of persons so engaged. Such association may have marketing agencies in common; and such associations and their members may make the necessary contracts and agreements to effect such purposes: *Provided, however*, that such associations are operated for the mutual benefit of the members thereof, as such producers, and conform to one or both of the following requirements:

"First. That no member of the association is allowed more than one vote because of the amount of stock or membership capital he may own therein, or,

"Second. That the association does not pay dividends on stock or membership capital in excess of 8 per centum per annum.

"And in any case to the following:

"Third. That the association shall not deal in the products of non-members to an amount greater in value than such as are handled by it for members."

TCCA fully qualifies thereunder. Furthermore it is alleged in the second amended complaint, paragraph II (R. 381) that TCCA is an Oregon cooperative corporation "... organized and existing under and by virtue of the Oregon Cooperative Corporation Act ... and is an agricultural cooperative and marketing agency for its members and patrons."



## **II. Summary Judgment was Properly Granted With Respect To the Attempt to Monopolize Charge Against Warren McMinimee.**

In granting the motion for summary judgment with respect to the attempt to monopolize charge against Mr. McMinimee, the trial court recognized that his relationship with the others was purely that of attorney-client. Despite ample opportunity, appellant was unable to show anything different.

At the hearing on October 5, 1964, the court was disposed to grant appellees' motion to the extent of dismissing Mr. McMinimee as a defendant.<sup>42</sup> However, in view of appellant's counsel's representation that given additional opportunity for discovery he would show the court that Mr. McMinimee acted other than as a lawyer and general counsel for TCCA, the court did not dismiss Mr. McMinimee at that time.<sup>43</sup>

The inclusion of Mr. McMinimee as a defendant was not only legally improper and completely unnecessary to protect appellant's alleged rights, but it was a reprehensible attempt to place him and his clients under the disabilities incident to their being co-defendants in the same lawsuit

## **III. Summary Judgment is Particularly Appropriate in the Present Case.**

Rule 56 F.R.C.P. provides in pertinent part:

“(b) For Defending Party. A party against whom a claim, counterclaim, or cross-claim is as-

---

<sup>42</sup> Tr. 209, 212.

<sup>43</sup> Tr. 216.



serted or a declaratory judgment is sought may, at any time, move with or without supporting affidavits for a summary judgment in his favor as to all or any part thereof.

(c) Motion and Proceedings Thereon. The motion shall be served at least 10 days before the time fixed for the hearing. The adverse party prior to the day of hearing may serve opposing affidavits. The judgment sought shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law. A summary judgment, interlocutory in character, may be rendered on the issue of liability alone although there is a genuine issue as to the amount of damages."

\* \* \* \* \*

"(e) Form of Affidavits; Further Testimony; Defense Required. Supporting and opposing affidavits shall be made on personal knowledge, shall set forth such facts as would be admissible in evidence, and shall show affirmatively that the affiant is competent to testify to the matters stated therein. Sworn or certified copies of all papers or parts thereof referred to in an affidavit shall be attached thereto or served therewith. The court may permit affidavits to be supplemented or opposed by depositions, answers to interrogatories, or further affidavits. When a motion for summary judgment is made and supported as provided in this rule, an adverse party may not rest upon the mere allegations or denials of his pleading, but his response, by affi-

avits or as otherwise provided in this rule, must set forth specific facts showing that there is a genuine issue for trial. If he does not so respond, summary judgment, if appropriate, shall be entered against him."

The purpose of Rule 56 "is to dispose of cases where there is no genuine issue of fact even though an issue may be raised formally by the pleadings."<sup>44</sup> The sufficiency of the allegations of a complaint do not determine a motion for summary judgment particularly where they have been pierced and where the state of the record shows that there is no genuine issue of material fact to be tried despite formal conflicts in the pleadings.<sup>45</sup>

The appropriateness of summary judgment in a situation such as the present was emphasized by the July 1, 1963 above-quoted amendment to Rule 56(e).

Appellant here is relying on its own assertions—the conclusory matter in the complaint—rather than on supporting facts to show that there is a genuine issue for trial. As pointed out in the note of the Advisory Committee accompanying the amendment to Rule 56(e), and in cases applying the amended rule, when one has by affidavits, depositions and otherwise denied the existence of the charges and any material fact and moved for summary judgment, the burden is placed on the party opposing the motion to come forth with *specific*

---

<sup>44</sup> *Koepke v. Fontecchio*, 9 Cir., 1949, 177 F.2d 125, 127.

<sup>45</sup> *Lindsey v. Leavy et al*, 9 Cir., 1945, 149 F.2d 899; *Byrnes v. Mutual Life Insurance Co. of New York*, 9 Cir., 1954, 217 F.2d 497; *MacKay v. American Potash & Chemical Co.*, 9 Cir., 1959, 268 F.2d 512.

*facts*, not with generalized denials and conclusory statements contained in pleadings and affidavits, to establish the existence of a genuine triable issue of fact.<sup>46</sup>

A reading of the complaints<sup>47</sup> herein shows that appellant really doesn't have any claim against appellees under the antitrust laws. And the trial court could well have dismissed the entire complaint instead of granting only partial summary judgment. This case is just another expression of the bitter acrimony existing between the parties which has manifested itself in a series of lawsuits on various issues in the state and federal courts.

Appellant is an admitted newcomer in the marketing of dairy products and has suffered the problems and frustrations of anyone launching itself into a highly competitive market with no prior experience. Appellant seeks to blame appellees for all its problems and to cloak its mistakes and failures as part of a sinister plot on the part of appellees to destroy appellant's business.

Conclusory statements in a complaint alleging violations of the antitrust laws are not favored and a properly supported motion for summary judgment is the correct way of attacking such a complaint and determining

---

<sup>46</sup> Advisory Committee note accompanying Rule 56(e); *Scolnick v. Lefkowitz*, 2 Cir., 1964, 329 F.2d 716; *Weyerhaeuser v. Gershman*, 2 Cir., 1963, 324 F.2d 163; *Norton v. McShane*, 5 Cir., 1964, 332 F.2d 855; *Pugliano v. Staziak*, D.C.W.D. Pa., 1964, 231 F. Supp. 347; *State of Maryland v. U. S.*, D.C.E.D. Pa., 1963, 221 F. Supp. 740.

<sup>47</sup> R. 1, 92, 380.

whether there is really any triable issue between the parties.<sup>48</sup>

Appellant has placed heavy reliance on *Poller v. Columbia Broadcasting Co.*, 1962, 368 U.S. 464, 7 L. Ed. 2d 458 as barring summary judgment in antitrust cases.<sup>49</sup> Examination of the facts and later Supreme Court cases shows that no such bar exists.

*Poller* involved an alleged conspiracy under Sections 1 and 2 of the Sherman Act to eliminate a particular radio station and to destroy ultrahigh-frequency broadcasting. The alleged co-conspirators included CBS, one of CBS's divisions, and an individual named Holt, whom CBS had hired to perform a particular job. Plaintiff's complaint centered on CBS's cancellation of a broadcast affiliation agreement. Defendant moved for summary judgment, asserting among its grounds of defense, first, that there were no capable conspirators since CBS could conspire neither with its own division nor with its temporary agent Holt, and second, that in any event, the cancellation of the affiliation agreement was not a violation of the antitrust laws. Material submitted in connection with the motion included affidavits of several CBS officers, affidavits from certain of the alleged co-conspirators, and the deposition of CBS's president and that of a vice-president. The trial judge decided the motion in defendants' favor on the ground that the can-

---

<sup>48</sup> *Becker-Lehman, Inc. v. Firestone Tire and Rubber Co.*, D.C. Md., 1959, 202 F. Supp. 514; *Krug v. International Telephone & Telegraph*, D.C. N.J., 1956, 142 F. Supp. 230; *Arzee Supply Corp. of Conn. v. Ruberoid Co.*, D.C. Conn., 1963, 222 F. Supp. 237.

<sup>49</sup> Appellant's Opening Brief, pp. 25-27, 34, 35.

cellation of the affiliation agreement was an exercise of a legal right. The court of appeals affirmed.

The Supreme Court reversed with the warning that summary judgment should be used sparingly in complex antitrust cases involving conspiracy, where motive and intent play leading roles. It coupled this warning to the following significant statement:

"It is only when the witnesses are present and subject to cross-examination that their credibility and the weight to be given their testimony can be appraised."<sup>50</sup>

The Supreme Court did not say, as appellant suggests, that summary judgment is particularly inappropriate in an anti-trust suit.<sup>51</sup> Indeed, in a later case, *The White Motor Co. v. U. S.*, 1963, 372 U.S. 253, 259, 9 L. Ed. 2d 738, 744, the Court said that "Summary judgments have a place in the antitrust field, as elsewhere . . . ."<sup>52</sup> In *Poller*, the Court said merely that where motive and intent play leading roles, and where a trial court has not had an opportunity to observe the demeanor of witnesses on the stand in order properly to evaluate their credibility, summary judgment may be inappropriate. As the warning clearly indicates, the court focused its concern on the importance of live testimony in a conspiracy case rather than on a general unavailability of summary judgment in all antitrust suits. A comparison of the record in *Poller* with that in the present case demonstrates that its warning does not

---

<sup>50</sup> 368 U.S. at 473, 7 L. Ed. 2d at 464.

<sup>51</sup> Appellant's Opening Brief, pp. 21, 25-27.

<sup>52</sup> Nothing in Rule 56, F.R.C.P., suggests that antitrust suits are excepted from or treated specially under its provisions.



apply here because ours was not a trial by affidavits. Motive and intent of appellees were of no significance and in any event the trial court had the benefit of substantial live testimony.

In *Poller*, the materials presented to the trial court were completely documentary. They comprised two depositions and some affidavits. Here, the materials before the court, were extensive and exhaustive, including both documentary and live testimonial evidence. Early in the proceedings the trial court indicated an awareness of the need for a full record before ruling on summary judgment.<sup>53</sup> In addition to the numerous affidavits submitted by both parties, detailed answers to interrogatories by appellees, and depositions of individuals connected with TCCA, appellant took the testimony of the two key conspiracy witnesses, McMinimee and Cadonau in open court.<sup>54</sup> With respect to the alleged activities of these two persons appellant, in effect, had the benefit of a trial.

The record shows that from the beginning of this litigation, appellees have demonstrated a willingness and eagerness to expose the relationships between themselves, Warren McMinimee and with Carl Cadonau and Alpenrose Dairy. The first motion for summary judgment, for example, concluded with an offer to have Messrs. Cadonau, Dixon and McMinimee available to testify before the court at the hearing on the motion.<sup>55</sup>

---

<sup>53</sup> Tr. 205.

<sup>54</sup> Testimony of McMinimee, Tr. 239-268; Testimony of Cadonau, Tr. 268-307.

<sup>55</sup> R. 108.



At the hearing on October 5, 1964, appellees opened with an offer to put a witness, later identified as Carl Cadonau, on the stand,<sup>56</sup> but appellant's counsel objected to appellees presenting any live testimony.<sup>57</sup> Finally, at the hearing on November 30, 1964, when both Mr. Cadonau and Mr. McMinimee were questioned in court, they responded frankly to a searching examination of their conduct.

The spirit of openness and opportunity for direct confrontation which has prevailed in this matter contrasts sharply with the kind of drama that was the background in *Poller*—a drama of hostile conspiratorial witnesses hiding behind paper assertions of innocence.

A number of recent cases, decided since *Poller*, have demonstrated the continuing appropriateness of summary judgment in antitrust suits.

*Bond Distributing Co. v. Carling Brewing Company*, D.C. D. Maryland, 1963, 32 F.R.D. 409, aff'd, 4 Cir., 325 F.2d 158, involved an alleged conspiracy to dominate, and an attempt to monopolize, the brewing industry in the United States. Defendant moved for summary judgment. The trial court, aware of the warning in *Poller*, but concluding that plaintiff had shown nothing to support its claims, granted the motion.

*Savon Gas Stations v. Shell*, D.C. D. Maryland, 1962, 203 F. Supp. 529, aff'd, 4 Cir., 309 F.2d 306, involved a suit for alleged violations of Sections 1 and 2 of

---

<sup>56</sup> Tr. 162, 202.

<sup>57</sup> Tr. 163.

the Sherman Act. Defendant moved for summary judgment. The trial court granted the motion on the ground that the material facts, which were not in dispute, did not spell out an antitrust violation. In granting the motion, the court discussed the *Poller* case, noting its warning, but concluding that summary judgment was still equally applicable to all civil litigation, and that a case such as the one then before it, involving no material fact dispute, was an appropriate one for even a sparing use of summary judgment.

In *Fiumara v. Texaco, Inc.*, D.C. E.D. Pa., 1962, 204 F. Supp. 544, affirmed, 3 Cir., 310 F.2d 737, the trial court granted motions for summary judgment in favor of four oil companies and an association of oil companies charged with violations of Sections 1 and 2 of the Sherman Act. With respect to the association, its motion was granted because nothing was presented to support its inclusion as a conspirator. With respect to the four oil companies, their motion was granted because the conclusory allegations in plaintiff's amended complaint, in the face of facts presented in defendants' documents supporting the motion, were insufficient to create a material fact dispute. In a footnote to its opinion, the court distinguished *Poller* on the ground that here plaintiff had failed to present facts sufficient to show a real dispute.

Other recent cases where summary judgment has been granted include *Gold Fuel Service, Inc. v. Esso Standard Oil Co.*, D.C. D. N.J., 1962, 195 F. Supp. 85, affirmed, 3 Cir., 306 F.2d 61, and *United States v.*

*Johns-Manville Corp.*, D.C. E.D. Pa., 1964, 237 F. Supp. 885.<sup>58</sup>

## CONCLUSION

Examination of the facts revealed by the exhaustive discovery procedures and court hearings in this case discloses that the assertions in the complaint are bottomed only on a hope that at a full trial something might develop that would support appellant's claims. However, as matters now stand, despite exhaustive inquiry, appellant has failed to show (a) the existence of any case against Warren McMinimee; and (b) a claim for alleged conspiracy against any of the appellees.

---

<sup>58</sup> The *Johns-Manville* case involved a civil suit against several companies charging violations of Sections 1 and 2 of the Sherman Act. There had been a previous related criminal trial against some of the defendants before the same judge. In granting a motion for summary judgment, the court said, at p. 893:

"The condemnation of trial by affidavit in cases such as *Poller v. Columbia Broadcasting System, Inc.*, 368 U.S. 464, 82 S. Ct. 486, 7 L. Ed. 2d 458 (1962), construed in the light of the subsequent amendment to Rule 56(e), is inapplicable to the instant case, where the Government relies chiefly on the allegations in its pleadings. The instant case is also distinguishable from *Poller* in that the record consists of testimony given by witnesses, during a criminal trial lasting over four months, who were subject to cross-examination and who had their demeanor appraised by the undersigned."

In the present situation, two of the defendants, TCCA and TC&DA, have recently been involved in a trial before the same judge. In that trial, which involved ownership and use of a trademark, the relationships between the parties was developed in the record. The earlier case is reported at 143 USPQ 12.

The partial summary judgment granted by the trial court was most appropriate and should be affirmed.

Respectfully submitted,

J. PIERRE KOLISCH  
1004 Standard Plaza  
Portland, Oregon 97204  
Attorneys for Defendants-Appellees

KOLISCH & HARTWELL  
JON M. DICKINSON  
1004 Standard Plaza  
Portland, Oregon 97204  
Of Counsel

# **CERTIFICATE OF COUNSEL**

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

J. PIERRE KOLISCH  
Attorney for Defendants-Appellees

